

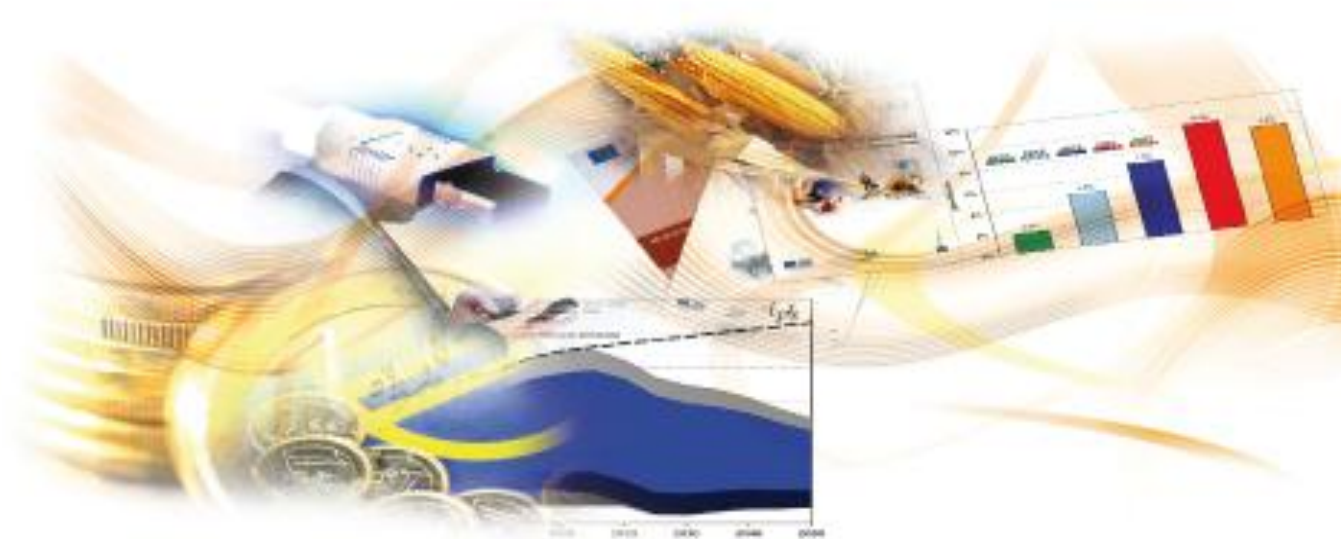


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Crowdfunding and the Role of Managers in Ensuring the Sustainability of Crowdfunding Platforms

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Disclaimer: The views expressed are those of the author and may not in any circumstances be regarded as stating an official position of the JRC or the European Commission.

Preface

As the Internet pervades the economy and society, new tools and cultural models for human activity are being developed that change the practices and possibilities of work: the way that tasks are executed, how they are organized; how human capital is contracted, exploited and developed; and the ways and places that people are able and choose to work and develop their working lives.

In the current economic context where a key policy emphasis is on employment, the JRC-IPTS Information Society Unit undertook a project, ICT for Employment - Future Work, to build understanding of four novel forms of internet-mediated work activity, both paid and unpaid: online work exchanges, crowdfunding, online volunteering and internet-mediated work exchanges (time banks). The project comprised a set of parallel studies of the state of understanding and practice in these areas, and in-depth qualitative studies of the users and creators of services based on these concepts, analysed from the perspective of employability.

These studies capture some of the ways work, and pathways into work, are changing, in order to identify whether these changes offer opportunities for policy to promote employment and growth, or whether they represent new challenges with respect to labour markets and employment conditions, such as creating new barriers to participation in the labour market. There is considerable public, private and third sector activity in these areas, and many initiatives can be seen as models of social innovation. The findings are relevant to policy concerns in a range of EU policies, most notably, the Agenda for New Skills and Jobs, and specifically the *European Commission Employment Package 2012* Key Action 8 which identifies a need to "Map new forms of employment", and the *Social Investment Package 2013*.

The studies are both descriptive and analytic and set out to answer:

1. How do new internet-based systems based on exchange or donation of labour, or capital provision, operate from both the user and operator perspectives?
2. What are the opportunities and challenges that each of these types services present to policy?

The following reports have resulted from the project ICT for Employability.

Thematic reports:

- i. Internet-mediated Volunteering in the EU: history, prevalence, approaches and relation to employability and social inclusion;
- ii. The potential of time banks to support social inclusion and employability: An investigation of the use of reciprocal volunteering and complementary currencies for social impact;
- iii. Crowdfunding and the Role of Managers in Ensuring the Sustainability of Crowdfunding Platforms;
- iv. The Value of Crowdfunding;
- v. From Cloud to Crowd: Online work exchanges for contract and crowdsourced labour;

Synthesis reports:

1. CrowdEmploy: Crowdsourcing Case Studies. An empirical investigation into the impact of crowdsourcing on employability;
2. Exploratory Research on Internet-enabled Work Exchanges and Employability (the present report);
3. ICT for Employment, Future Work Final Report, Four trends in paid and unpaid work: implications for employability.

These reports are available on the JRC-IPTS website:

<http://is.jrc.ec.europa.eu/pages/Employability-TheFutureofWork.html>

Executive Summary

Crowdfunding is a new financial system with its own particularities. It is a low-cost way of accessing capital, which increases the potential audience for ideas and ventures, reduces the risk of investment, and provides tailored financing methods for a wide variety of projects. It also provides finance in sectors of activity where finance is difficult to obtain and allows entrepreneurs to test the acceptance of their products in a short period of time.

But crowdfunding is also about attracting the emotional interest of users, setting up channels of identification with a platform's core values and purposes and exploiting the capabilities of social networks, community and proximity. This brings about new interactions between economic efficiency and democratic practices which are distinctive of the crowdfunding market.

A particular way of managing the highly idiosyncratic crowdfunding practices seems to have emerged, which underlines the advantages of reinforcing the “economic efficiency-democracy practices” mix (Efficiencracy). Managers interviewed in the study on which this report is based have reported that transparency, participation, learning communities and open-information benefit economic efficiency, and success reinforces democratic practices.

Managers are committed to reducing investment risks, allowing the best projects to go forward, assisting creators and funders, facilitating transactions and verifying customer rights to create a more secure and efficient environment for investment. They also promote bottom-up initiatives under more transparent rules and practices, allowing new forms of democratic coordination to optimise the relationship between supply and demand.

Managers promote democratic practices to encourage trust, involvement and cooperation. They use different strategic options to increase the “right participation” through their platforms purpose and mission statements.

So far, public institutions have not been very active in crowdfunding. They are, however, increasingly interested in the possibilities of new sources of revenues, economic growth, employment creation and novel forms of co-financing and democratic input to funding.

Evidence suggests that the development of crowdfunding is likely to be conditioned by increasing specialisation, the emergence of new target areas (science and political activism) and the emergence of a new layer of consultant companies which specialises in crowdfunding services (at the moment in the hands of the platform managers).

Yet, the expansion of the crowdfunding industry may activate a latent conflict of interests between creators and investors, small and big investors, platforms and public institutions. A series of risks may hinder this market's consolidation.

Novelty, continual change, uncertainty about accountability and regulations, lack of awareness of good practice in collaborating with public institutions, research and knowledge and doubts about platform sustainability are serious obstacles to consolidation. The rather limited capacity of platforms to mediate in conflicts between entrepreneurs and funders, delays in meeting obligations, problems of post-investment communication among stakeholders, the lack of follow-up services to check the sustainability of the projects launched, different tax regimes, two-tier legislation and the preference for the small are also obstacles to the consolidation of the crowdfunding market.

A series of policy recommendations have been made in this report, mainly focussing on “awareness raising programmes” in close collaboration with the crowdfunding industry and “learning programmes” for potential users still not familiar with crowdfunding. A “harmonised regulatory framework” and “Reduction of risk programmes” aim to increase security in transactions, and to protect ideas and investment.

The allocation of budget to finance projects which fail to achieve their target budget, reduction of tax burden for crowdfunding services and a certificate of excellence have also been suggested as ways of encouraging participation. Similarly crowdfunding opens up new forms of professional

activity and labour inclusion, which require a revision of certain active labour policies, and their design, implementation and evaluation.

Finally, some measures have also been suggested to prevent appropriation, clientelism and bureaucratisation when public institutions participate as investors and donors in crowdfunding. Similarly, measures for public institutions to receive community-based funds have also been put forward. Finally, new emphasis on policies promoting international legislation and taxation is recommended under the umbrella of what could be called the European Crowdfunding Area (ECA).

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1. Introduction

Crowdfunding is an alternative way of finance and exchange, where those seeking funding and those looking to invest or donate can be matched. Creators and entrepreneurs can make use of these online crowdfunding platforms to expand the numbers of potential investors and donors, who finance their online project via the Internet. Yet, crowdfunding is not just about raising money, but also about market testing, engaging potential customers and target groups and exploiting the advantages of community and proximity.

There are at least four different types of crowdfunding platforms:

- *Equity-based platforms* which specialise in projects that provide investors with tangible benefits, mainly profits.
- *Lending-based platforms*, which seek to lend capital in exchange for interests;
- *Rewards-based platforms* which provide rewards, usually products like Dvds, t-shirts, etc. in exchange for users' capital contributions.
- *Donation-based platforms* which seek to attract donations for specific projects, mainly social, in exchange for non-material rewards (solidarity, sense of belonging etc.), see Chapter 3.

These alternative means of finding finance increase the opportunity for investment by attracting the interest of a wide range of people in ways beyond conventional lending channels ("the crowd"). Therefore social networking is central in crowdfunding. Success in raising money for a project highly depends on the ability of crowdfunding users to mobilize their social networks.

Furthermore, pooling people's abilities to build collective intelligence is also considered an added value in crowdfunding practices ("the wisdom of the crowd"). Crowdfunding can efficiently exploit the advantages of community, proximity, innovation and disintermediation to boost economic activity and employment, especially in sectors where finance is difficult to obtain.

The preference for the small is also distinctive of crowdfunding. Instead of raising money from a very small group of rich investors, crowdfunding sets out to obtain funds from a large audience, where each individual provides small amounts of money.

For all these reasons, crowdfunding is becoming a growing form of business (Hemer, 2011; Carr, 2011). There are 452 crowdfunding platforms active worldwide, which have raised almost \$1.5 billion. They funded more than one million campaigns in 2012 and \$5.1 billion is forecasted for 2013 (Masssolution, 2013). In Spain, a prototype economy in recession, crowdfunding has attracted more than €400 million through 2,825 CF projects, which created 7,500 direct crowd-jobs in 2012 (Ramos & Gonzalez, 2013).

However, the expansion and adoption of crowdfunding is not without its critics. Despite a promising early start, crowdfunding may not be so fruitful in the future. Crowdfunding is above all new, and novelty often clashes with social norms, established productive models and entrenched regulation and laws, all of which can hinder its successful development. .

Furthermore, there are still many unknowns related to the skills and professional preparation needed to manage e-networks, the lack of legislation to protect ideas and investment, the limited scope of crowdfunding services and the lack of sufficient knowledge and empirical data on the factors and functions that help to explain the up-until-now unforeseeable and complex behaviour of the crowd.

Moreover, crowdfunding projects are exposed to a public audience, with the consequent risk of plagiarism and copycats, mainly on the part of big companies which can use their greater economic and legal resources to take advantage of the ideas circulating through crowdfunding platforms.

Crowdfunding can be a useful tool to finance small budget projects. However, projects that require large investments are harder to finance because in general it is difficult to reach a large target budget by encouraging large audiences that only provide small amounts of money. If this element loses importance in favour of maximising profits, the crowd component of crowdfunding will become less and less central. This tension between business interests and democratic participation is central and will be analysed throughout the whole report.

Crowdfunding is being created by the users and the entrepreneurs who establish the platform and seek to stimulate crowdfunding activities. The crowdfunding platforms are themselves early stage businesses, which need to find a sustainable business model – many may not survive in their current form. While there is some emerging evidence from surveys as to factors that shape crowdfunding success, there is little research into how the platforms are developed and operate. The role of platform managers in dealing with the potential and limitations of crowdfunding is crucial, yet we know very little about how they run their companies. This report strives to shed some light on managers' strategies for dealing with current challenges to ensure the sustainability of their platforms.

1.1. Aim of the report

This report, commissioned by the Institute for Prospective Technological Studies (IPTS)¹ carries out the fundamental tasks of exploring managers' strategies, reservations and expectations on the sustainability of their crowdfunding companies. It scrutinises the interplay between managers and users to make the company more efficient and attractive for business and solidarity. It also focuses on the business models of each company as they try to improve in areas such as professionalization, transparency and protection of ideas, investments and donations.

Through empirical cases, the report seeks to understand how managers evaluate the effect of the current legislation (or the lack of legislation) on the functioning of their companies, how taxation affects their business model and the kind of personal assistance that crowdfunding companies provide in order to enrol supporters and to increase a project's chance of success.

Finally it investigates managers' positions on policy issues of significant importance such as the harmonisation of legislation, taxation and good practices at the European level and the role of local institutions in promoting crowdfunding services in their regions or municipalities

The report studies four issues addressed in the literature, which are identified as the most important challenges affecting the viability of crowdfunding services:

- i) *User (Manager) Factors or Motivations*: managers' motivations to set up and run a crowdfunding platform.
- ii) *Success Factors*: the determinants of a projects' success or failure
- iii) *Regulation*: how managers deal with fraud, taxation and legislation
- iv) *Public Institutions*: how managers trace connections with public administrations and how administration cooperate with crowdfunding platforms and users.

¹ IPTS (Institute for Prospective Technological Studies) is one of 7 research institutes that form the European Commission's Joint Research Centre.

2. Method

2.1 Secondary sources

The number of academic papers and comparable data is still rather limited. Instead, we had to rely on data and analysis generated by actors working in the industry as entrepreneurs, investors, and intermediaries. Much of this has been published in web-based articles and blogs over last three years. Particularly noteworthy are the contributions that industry analyst web-sites such as Massolution, Crowdsourcing, Dailycrowdsource, lpledg or Crowdfundinsider are doing to spread news, experiences and knowledge on the evolution of the crowdfunding sector, especially in the USA.

Given the novelty of this financial method, literature found on this topic is often somewhat descriptive, so that findings and policy implications should be taken with caution. Fortunately, the expansion of crowdfunding is now attracting scholars interested in tracing explanatory connections between the functioning of crowdfunding platforms and their socio-economic consequences.

Some academic papers referred to in this report are based on studies of a single platform in a particular sector. Some examples are Mollick (2013) in his analysis on the dynamic of success in USA based on one platform (Kickstarter), and the case of Carr (2012) which focuses on patterns of success in one particular sector (Role playing games).

At the other end of the spectrum, other researchers are trying to create a general framework for understanding crowdfunding as a whole. This is the case with Buysere et al. (2012) in their “Framework for European Crowdfunding”, Steinber, & De Maria (2012) in their “Crowdfunding Bible”, Veugelers (2012) in his “Crowdfunding Platforms for European Growth” or Rothler and Wenzlaff, (2011) “Crowdfunding Schemes in Europe”.

Very few papers specifically dealing with the connection between crowdfunding and employment have been found, apart from the one carried out by Ramos and Gonzalez (2013) on the case of Spain. It still has no robust, empirical and differentiated data on economic activity and employment that would allow researchers and policy makers to properly evaluate the real economic impact of crowdfunding practices.

2.2 Empirical data

To complement the rather limited available research, this report draws on original empirical material gathered in the form of short cases studies. Given the limitations of the project, these are based on a small number of in-depth semi-structured online interviews with crowdfunding service managers. These are analysed in inductive manner to gain understanding on the questions raised in the project brief and in the literature. The data obtained through the interviewees has been coded to build a holistic picture of how managers operate to ensure the sustainability of their crowdfunding services.

Since crowdfunding is used for a variety of different activities, and using different models, a purposive selection of cases was made, based upon the criteria of specialisation (equity, lending, reward, donation), and covering a range of different EU national contexts. The choice was also limited by access and resources. The five platforms studied are:

- **Symbid** – (The Netherlands). This is an equity-based crowdfunding platform that seeks to promote ownership for everyone and raise money for potentially profitable projects by reinforcing secure frameworks for business and increasing efficiency and transparency.
- **Onepercent**– (The Netherlands) is a donation-based crowdfunding platform which aims to finance small-scale development projects to give people direct access to the necessary

means to improve their lives under principals of sustainability. The idea is to convince people to offer 1% of their time, knowledge and income to support development projects.

- **Verkami**- (Spain-) is a reward-based crowdfunding platform whose main objective is to raise money for innovative projects and ideas. In order to favour innovation, this platform promotes a secure environment and an exhaustive selection process to choose only the most innovative projects.
- **Crowdculture**- (Sweden) is a reward-based crowdfunding platform whose main priority is to connect social capital with economic capital for culture projects through a combination of crowdfunding and public grants. This platform is a good example of a hybridised crowdfunding platform to bring together private initiatives and public funds in the cultural sectors under democratic practices.
- **LeihDeinerStadtGeld** (Germany-). This is a lending-based crowdfunding platform whose mission statement is to enhance democratic model of municipal financing. This platform advises municipalities on community-based funding models in order to avoid high dependency on banking loans. It runs settlement of financing via citizen loans and promotes the integration of citizens' credit in the municipal budget.

The interviews focused on the practices, motivations and experiences of managers running crowdfunding platforms, how and why these Internet-based services have been set up, configured and developed, their form and development from the perspective of managers (including user needs and practices, legal and technical factors, how issues such as trust and reputation are managed through technical and non-technical means).

2.3 Questions to managers

The managers of the firm were asked the following set of questions, which seek to shed light on managers' strategies for operating their business models so as to increase their efficiency and how they deal with the current challenges identified above.

- a. What were the factors (**motivations**) that led to the creation of your company?
- b. What do you know about your **users**? Who they are? What are the main features of funders and entrepreneurs? What are the main trends in projects and funding and what is their most relevant potential and limitations?
- c. Does your company provide any kind of **personal assistance** to entrepreneurs and funders on how to prepare and launch projects, how to mobilise social networks etc., and how and where to invest?
- d. Once a particular project has been raised, do you **follow it up** and/or trace post-investment communication in order to check out its sustainability?
- e. Do you provide users with **legal assistance**? If yes, do you provide legal assistance at market prices, at reduced cost, or for free?
- f. Do you think that the risk of **fraud** is a real challenge negatively affecting the prospect of growth of your company, or on the contrary, are we may be creating an issue out of nothing as fraud has only a marginal effect?
- g. What other issues cause concern in your crowdfunding services?
- h. Are you in favour of setting up minimum and maximum **investment thresholds**? If so, why?
- i. In what way has **legislation** (or the lack of legislation) influenced/conditioned your business model (in the setting-up and the taking-off phases)?
- j. Do you consider the **tax burden** low, acceptable or high for your business model to consolidate and to grow? In your view, what kind of tax policies should be launched to benefit the sustainability of CF services?
- k. Are you in favour or against **tax harmonisation** in CF practices at the European level? Why?
- l. How would you expect **public institutions** to support the start-up, consolidation and expansion of crowdfunding services?

3. Definitions

This section explains some of the key elements of crowdfunding, and the terminology that will be used in this report to describe it.

3.1 What is crowdfunding?

Rubinton (2011:5) suggests that crowdfunding answers three fundamental questions about how our economy operates:

- I. who decides which projects deserve financing?
- II. how can we guarantee they represent the projects' target markets?
- III. what can we do to systematically reduce entrepreneurs' exposure to the risk that they fail to cover their start-up costs?

Crowdfunding seems so economically relevant because of the way in which crowdfunding works and how crowdfunding users operate. Steiner and DeMaria (2012) define crowdfunding as the process of asking the general public for investment and donations through Internet for new ventures. Crowdfunding involves an *open call* for the provision of financial resources, either in the form of donations or in exchange for some form of rewards and/or voting rights, in order to support initiatives for specific purposes (Lambert & Schwienbacher, 2010).

A key idea in crowdfunding is to attract large audience from various sources where each funder provides a small amount of money instead of small group of investors providing larger amounts of capital. This preference for large numbers of people, each contributing a little, is thought to have a high impact on financial opportunities for start-ups (Belleflamme *et al.* 2010; Belleamme, Lambert & Schwienbacher, 2012)

Another key idea is to encourage users' participation to obtain ideas and solutions, improve the quality of the launched products and the efficiency of investments and donations. Creators not only get funds from investors, but also technical feedback on almost every single aspect of the financing process (Brabham 2008; Kleemann *et al.* 2008). Crowd-investors do not look much at collaterals or business plans, but at the *ideas and core values of the firm*. Therefore crowdfunding offers tailored financing methods by using, not only technical financial factors, but also people's values and opinions, that fits well to the financing needs of start-ups in the current economic situation (Lehner, 2013).

Crowdfunding enables those looking for funding to *bypass the intermediaries of a traditional supply chain*. Money seekers can now bypass banks, venture capitalists, business angels or public financing regimes thus making funding processes more transparent and democratic. These traditional mediators see the rise of crowdfunding as competition or a threat to their business models (Rothler and Wenzlaff, 2011). Lehner (2013:18) suggests that the examination of platforms as amplifiers and mediators, creating quasi-super nodes, and their links with payment providers is crucial in understanding the sustainability of the crowdfunding industry.

For Hemer (2011:14) "what is new in crowdfunding is that it exploits the capabilities of *social networks and other new features of Web 2.0*, especially the function of "viral networking and marketing", which enables the mobilisation of a large number of users in specific Web communities within a relatively short period of time". Crowdfunding is typically empowered by social media communication over the Internet, using, for example, user-generated content as guides for investors (Lehner, 2013).

De Buysere et al. (2012:18) suggest that no other investment form, be it debt or equity, can provide the benefits of *pre-sales, market research, word-of-mouth and crowd-wisdom without additional cost*. The "Wisdom of the Crowd" (Surowiecki, 2004) is therefore central in crowdfunding practices.

Other factors do not help to consolidate crowdfunding practices. The all-or-nothing model, adopted by most platforms, where projects only receive money if they reach their requested target, could be considered inefficient because some projects are not released because they fail to reach their target by even small amount (Ramos & Gonzalez, 2012). A great deal of the literature explores the issue of how to define the target level to maximise success.

The sector faces a number of challenges today. De Buysere et al. (2012) underline the most important of these challenges, namely **fraud**, **setting valuations** (to decide how much equity to offer for the amount of capital someone wants to raise), **post-investment communication**, **reliable data and analysis**, **risk mitigation** and **conflict of interest** (when owner of funding providers use privy information to generate systematic superior returns compared to the crowd financing it).

3.2 Key terminology

Crowdfunding Platforms are the websites run by managers. It is the virtual space where creators and entrepreneurs launch their ideas and projects, and investors and donors economically support the ideas and projects launched.

Crowdfunding services. Around the platform there are a range of services that seek to increase participation (number of users) and the chance of success of the launched projects. These can be run by the platform promoters, or by other organisations. Services can be classified as three different types:

- i) *Technical services* are those services offered to improve the quality of the presented projects. The most common services are those focused on technical assistance to develop a campaign, to activate social networks, to identify target groups, to set a realistic target budget and to publicize the launched projects. In this category we can also include services to encourage collective cooperation. These services seek to set up learning communities to take advantages of the feedback and suggestions coming from users who participate in the whole productive process.
- ii) *Legal services* are those services designed to create secure environment for business and increase trust by users who pool the money to raise a project initiated by other users. Given the nature of crowdfunding there are still some unknown regarding protection of ideas, protection of investors and consumers, taxation and legislation.
- iii) *Advertising services* are those services in search of increasing participation by advertising the benefit of crowdfunding among wider stratum of the population beyond. Agreements with public institution to attract public investment are also part of these services.

Crowdfunding Managers: These are the people who run the platforms and help creators, investors and donors get more done by using strategic plans and directions to motivate users, to work toward common goals, and remove roadblocks. They also provide and receive feedback on the functioning of their platforms and products.

Crowdfunding Users refers to the people who use crowdfunding services. The most common players are, on the one hand, creators and entrepreneurs, and on the other investors, backers, donors and patrons. Each type of user shares some common set of ideas and practices regarding interest, motivations and strategic plans, but can also diverge in their interests. *Creators and entrepreneurs* are the people who launch a project, offering material and non-material rewards in return. *Investors* are those who pool money to raise a project in exchange for profits and/or shares of the company. *Donors* do not look for material rewards in return for their economic contribution but benefits of a non-material kind (sense of belonging, cooperation with fair causes). *Patrons* are those people who contribute money to a project in exchange for products or services, not profits.

Equity and lending platforms tend to be the “natural” space for *investment* in crowdfunding,

therefore investors are the prototype consumer of these platforms. Philanthropy explains why donors make material contributions to donations-based platforms without asking for anything in return. Patrons are the prototypical users of reward-based platforms. They usually seek to support a project in exchange for products (DVD, tickets for movies and concerts, t-shirts, etc.).

The Crowdfunding way of working. Crowdfunding has is a distinctive way of working. *Users* should follow, as a minimum, the following steps:

- i. choose the 'right' platform: i.e. the platform closest to their conceptions of business and cooperation,
- ii. set a realistic target budget for their projects.
- iii. set up a time limit for achieving the target budget.
- iv. define clearly the kind of profits or rewards they are willing to offer in exchange for investment or donation.
- v. create a campaign to advertise the project, which can be modified using the analytic metrics provided on many platforms.
- vi. connect with a social network to promote the project.
- vii. set up a channel of communication with potential users to get feedback about the project to improve the quality and its chance of success.

Crowdfunding practices are conditioned by some particularities, for example, time limit or all-or-nothing-rules. *Time Limit* means that once a project is launched, the platform sets up a period to achieve the target budget. If the project is not funded on time, then it is removed from the platform.

All-or-nothing means that *pledged* money is collected and rewards validated only if a project achieves 100% of its target budget. If pledge money or the fundraising goal is not met, then money is not collected. This way of working has received criticism, and other ways of operating have been proposed. "*Everything Counting*" is an alternative method in which, regardless of the percentage of the target budget achieved at the end of the campaign, the pledge money is collected and the rewards are validated.

Success and failure. Success in crowdfunding means completing an objective or reaching a target budget within a limited period of time. The real measure of success in crowdfunding is the projects that it makes possible. Successful projects achieve their target budgets (the pledged money), whereas failed projects do not.

4. Scales and Scope

4.1 Types of platforms

Crowdfunding takes a number of different forms regarding the different motives of the creators, funders and platforms. There are basically four crowdfunding models. A widely used taxonomy is set out by Buysere et al (2012), who differentiate crowdfunding models according to the terms under which money is provided to those raising the capital:

1. **Equity-based crowdfunding:** This is the platform for projects which offer a share in future profits. The main motivation of investors is to get a return on their investment, with other rewards or tangible benefits.
2. **Lending-based crowdfunding:** Investors can choose to lend money in exchange for interest when the goal is achieved and the project pays-off.
3. **Rewards-based crowdfunding:** participants receive non-financial rewards in exchange for their contribution. They back these projects for intrinsic or social motivations.
4. **Donation:** these are made for specific, mainly social, projects, which are usually managed by NGO's. Donors do not receive tangible benefits in exchange for their donations.

De Buysere et al (2012) also distinguish **pre-sales** (where funders order and pay in advance for a new product) and **social lending** (where money is lent to social projects without interest) as two different crowdfunding business models.

In addition to classifications of the types of platforms, other analysts classify types of projects offered through crowdfunding. The six models suggested by Hemer (2012:11/12) in his Snapshot Report are based upon two main criteria: the commercial background of the initiative and the original organisational embeddedness.

Commercial background:

- **Not-for-profit:** the project is intended to be non-profit with societally important goals: for instance in areas like public health care, public infrastructure for foreign development aid, general charities, public research projects, open source software, etc.
- **For profit:** the initiative pursues clearly commercial (for-profit) goals like setting up a company, funding a commercial project within an existing company, promoting new private goods (e.g. the installation of a wind farm by a utility), an R&D project within a company, the funding of a commercial film or a music album, etc.
- **Intermediate:** the project is not clearly assignable as it is not clear at the start how commercial it will be in the long run. Examples are entertainment or media (private and public) projects, new services or social networks on the Web which only later developed into commercial services, independent music albums and films on a mere subsistence basis, artistic performances and pieces of art, festivals organised by private organisations etc. and which often find a market only for a short time.

Organisational embeddedness:

- **Independent:** The initiative has no background in an institution or organisation and is set up by individuals.
- **Embedded:** Projects originally initiated by or from within an incumbent private or public organisation and originally intended to remain part of such an organisation.
- **Start-up:** These projects, that may be independent when they start, are meant to lead to the foundation of organisations (private or public) with unlimited scope. In other words, they start as projects with a defined end and then, after terminating successfully, are transformed into something like a firm, an association, a club, an authority, a foundation etc.

The growth in the overall number of platforms in the world coincides with certain level of platform specialisation in new sectors of activity. Crowdfunding initiatives in science or minority sports are gaining relevance. Platforms such as *InitiavitSciflies.org*, *Openginius.org*, *theopensourcescienceproject.com*, *fundscience.org*, are becoming a feasible alternative way of funding science. Researchers use these platforms to search for funds for their research, especially in economies in recession.

Projects which aim to support political campaigns have also increased. These can be run by activists seeking to raise money for paying bail for other protesters, campaigns to finance films, books and documentaries in favour of certain political issues including, anti-neoliberal globalisation, the environment, gender equality and the independence of non-state European nations such as Catalonia, Basque Country, Piamonte, etc. (Valenzuela, Arriagada, and Scherman (2012), Reyes and Finken (2012),

The spectrum of possibilities is so wide that it is difficult to foresee crowdfunding's next frontier. The expansion of crowdfunding is also encouraging the emergence of specialised e-companies that help users to connect with specific crowdfunding services to work out campaigns, get useful information on building project profiles, connect entrepreneurs with the most active social network and also get advice on the best opportunities for backers. Project2crowdfund² and Oncontracting³ are good examples of these e-firms which are highly specialised in crowdfunding services in USA.

Therefore the development of crowdfunding is likely to be conditioned by increasing specialisation, the emergence of new target areas (science and political activism) and the emergence of a new layer of consultant companies which specialise in crowdfunding services. These companies may assume certain responsibilities that, at the moment, are in the hands of platform managers.

4.2 Numbers of Platforms

There were 452 active crowdfunding platforms worldwide in 2011 (426 according to crowdfundinginsider,⁴). This figure was expected to increase to 536 by the end of 2012, up 60% on the previous year (Crowdsourcing.org, 2012). Crowdfunding platforms raised \$1billion in 2010 (Smartmoney)⁵ \$1.5 billion in 2011, \$2.7 in 2012 and it is forecasted that all crowdfunding practices taken together grew by 81%, reaching \$5.1 billion in 2013 (Crowdsourcing.org, 2013) although other more optimistic analyses forecasts \$6.1 billion in 2013 (Gartner Research).⁶ This money funded more than 1 million campaigns in 2012.

Table 1: US\$ billion raised in crowdfunding

Year	Fundraising (billions dollars)
2009	0.53
2010	0.85
2011	1.5
2012	2.8
2013	5.1
2013*	6.1

Source: crowdfundinginsider, Smartmoney, Massolution*Gartner Research.

² <http://www.projects2crowdfund.com/form-publish-your-crowd-fund-project>

³ <http://www.oncontracting.com/>

⁴ <http://directory.crowdfundinsider.com>

⁵ <http://www.smartermoney.nl/?p=671>

⁶ <http://www.crowdsourcing.org/document>

In the USA, there were 238 crowdfunding platforms in 2013, compared to 191 in 2011. Crowdfunding services are expected to expand the population of potential investors from 2 million to over 50 million, while increasing the amount of available capital from \$1 trillion to over \$5,000 billion (Hollas, 2012).⁷ The number of projects submitted that achieved their funding target, reached 45% in 2009, US\$ 50 being the most commonly-pledged amount (ipledge, 2012).⁸

“Strategy-of-innovation.com”⁹ calculated that in 2010, the 221 crowdfunding services in Europe raised around €300 million for crowdfunding projects. In 2012, crowdfunding in Europe saw an estimated 65% growth compared to 2011 and reached €735 million (Massolution, 2013).¹⁰ Regarding the number of platforms, Strategy-of-innovation.com places France as the leading European country in number of platforms, followed by the UK, The Netherlands and Germany, which all have more than 20 crowdfunding platforms. Just three years later, Crowdfundinsider¹¹ identified 185 platforms in Europe in 2013 compared to 239 in the USA, 21 in Canada, 10 in Australia, 6 in India, 5 in Brazil and China. The UK is now the European country with the highest numbers of platforms (42) followed by France (15), Spain (12), Germany (10), the Netherlands (7), Italy (6) and Finland (2).

Table 2: Evolution of number of crowdfunding platforms in Europe

	2010	2011	2013
France	72	22	16
UK	28	32	42
Holland	24	24	7
Germany	20	16	10
Spain	10	13	12/18*
Belgium	9	2	-
Switzerland	7	4	8
Italy	4	3	6
Finland	3	1	2
Sweden	3	3	3
Ireland	3	2	1
Czech	2	2	1
Denmark	1	2	1
Poland		3	1
Source	Strategyinnovation.com	Pleasefund.us	Crowdfundinsider.com *Ramos & Gonzalez (2013)

The first thing that attracts attention is the significant difference in the number of platforms from year to year in some economies. This suggests that the process of platform creation and destruction has a high turnover.

⁷ <http://www.crowdsourcing.org/document/how-to-make-crowdfunding-a-success/12854>

⁸ <http://ipledg.com/blog/?p=166>

⁹ See:

[http://www.strategy-of-innovation.com/pages/List of Crowd Funding Web Sites and Web Sites To Find Investors-4605700.html](http://www.strategy-of-innovation.com/pages/List_of_Crowd_Funding_Web_Sites_and_Web_Sites_To_Find_Investors-4605700.html)

¹⁰ <http://research.crowdsourcing.org/2013cf-crowdfunding-industry-report>

¹¹ <http://directory.crowdfundinsider.com/>

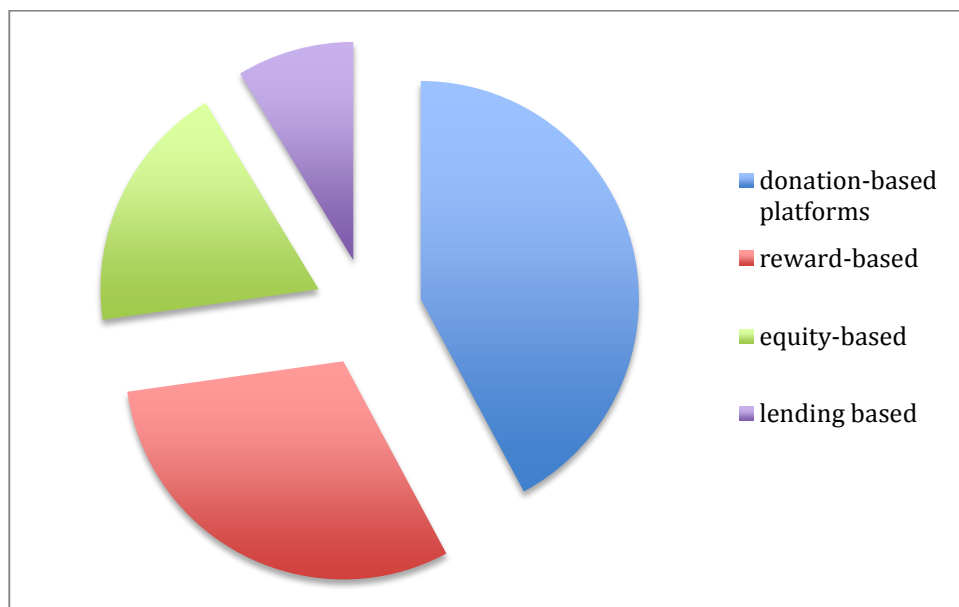
Particularly striking is the case of France, where more than 50 platforms were lost in the last three years. Holland, Germany, Belgium and Switzerland also suffer intense variations. The reasons behind this high turnover are not evident. From this report's standpoint, the fact that data come from different sources, which do not always use the same classification criteria, may explain these differences. The numbers of crowdfunding platforms in the UK and Spain show significant growth, whereas they remain stable in the rest of the countries.

85% of crowdfunding platforms are founded in the USA and Europe, and 15% in the rest of the world with Brazil (20 platforms), Canada (12) and Australia (7) ranking among the highest. Other countries with crowdfunding platforms are Japan (3), India (3), New Zealand (3), Russia (1), Argentina (1) and Chile (1).¹²

4.2.1 Breakdown by type of platform

Crowdfundinsider¹³ estimates the breakdown by type of platforms as follows. There are 175 donation-based platforms worldwide, followed by reward-based (127), equity (77) lending based (36) (Crowdfundinsider, 2013). This platform also classifies "support companies" (33) "Portal services" (16), "News and Information" (12) and "Accreditation" (1)

Figure 1: Types of platforms



Source: crowdfundinsider.com

According to data from Forbes (on 11/05/2012), the world crowdfunding market in 2011 could be broken down as follows: donations - 49% , loans - 22% equity - 18% and rewards 11%, in line with the figures proposed by Crowdfundinsider in Figure 1.

4.3 Outcomes

Attempts have been made to measure a number of indicators in crowdfunding: total money raised, number of projects funded, success rate in raising funds, and number of jobs created.

Evidence on rates of success (number of projects obtaining the target budget divided by the total number of projects submitted) is scarce and rather unreliable. Different rates of success are

¹² <http://www.pleasefund.us/projects/strength-in-numbers>

¹³ www.crowdfundinsider.com

attributed to Kickstarted depending on the source consulted (39.91% - 43.83%-39%) and the same applies to Indiegogo (13.68%- 40%-55%). All in all, information is more abundant in the USA than in Europe. Ramos and Gonzalez (2013) provide comparative data on success rates in Spain. The success rate is 23% in this country, below the world average (45%), and the USA average (75%). The most successful platforms are *Verkami* (81.39%), *Miaportacion* (80.00%) or *Lanzanos* (61.08%).

Young business and open innovation are some good examples of crowdfunding's potential in fuelling economic activity and employment. The high number of young users observed in this report indicates that crowdfunding may be addressing and improving the undercapitalisation of young business. This creates new spheres of professional activation and skill updating, which require active new labour policies.

Employment in crowdfunding is created through financing projects that employ or self-employ people. This is the real added value of crowdfunding: the projects that crowdfunding make possible and the employment needed to carry out these projects. As is frequently the case in crowdfunding, very little research has been done on the effect of crowdfunding on employment. Among the few existing analyses on this issue, Ramos and Gonzalez (2013) analysed the case of Spain in 2012, providing interesting results.

According to Ramos and Gonzalez, there were eighteen crowdfunding web-sites in Spain, which launched 2,825 projects during the examined period (January-December 2012), amounting to €430,963,927 (total target budget submitted) of which €121,367,740 has already been used to fund projects (cover rate 28.4%).

It is estimated that 7,564 direct crowd-jobs were created through crowdfunding in Spain in 2012. Since the funds raised for projects amounted to €5,137,642, this means that every €679.2 invested in crowdfunding projects generate a direct crowd-job. If all projects launched were funded, the number of direct crowd-jobs would increase by 5,553 totalling 13,117 jobs. If indirect jobs were also considered, we could safely say that around 25,000 jobs were created in 2012.¹⁴

Most of these jobs belong to the cultural and entertainment sectors (87.1%), and also to the technology, innovation and Internet (4.5%), social sectors (4.1%), entrepreneurship, start-ups (3.9%) and education (0.6). The average number of jobs by sectors is the following:

- Social sector - 3 jobs per project (average)
- Education - 4 jobs
- Start-up and Entrepreneurship - 6 jobs,
- Innovation, Technologies and Internet - 6 jobs,
- Cultural and Entertainment sector - 9 jobs.

¹⁴ Most projects on "Socios e Inversionistas" platform show not only the amount of funding required (target budget), but also the number of jobs they plan to create if the project is launched. For example 3 to 5 people to start a tapas bar (chef, waiter and cleaner), 3-5 workers in e-business of different kinds (1 general manager, 1 webmaster, 1 salesman and 1 secretary). 4 workers in a sales website (1 commercial manager, 1 purchase manager and 1 in marketing). 4-5 workers in a leisure and sports centre, (management, monitors and administration staff). 2-3 workers in the development and commercialization of patents. 3-4 workers in a rent and sale store of equipment for disabled people. 2 workers in a martial arts school. 10 workers in a kindergarden (1 director/general manager, 1 coordinator, 1 commercial staff member, 1 accountant, 1 receptionist, 5 teachers) and so on. We have applied these numbers to other published projects in different platforms.

5. Key Themes in Crowdfunding: a Review of the Literature

The academic and grey literature on crowdfunding focuses on four main themes:

- 1) *User factors or motivations*. The reasons why people participate in crowdfunding are not very clear yet. Some literature has explored why users invest or donate money, use crowdfunding platforms to build support, or set up and run a platform. Motivation has to do with how crowdfunding users interpret crowdfunding. For some, crowdfunding is above all, a new economic paradigm, embedded in the new logic of the Digital Society, whereas for others, crowdfunding is another way of doing business.
- 2) *Success Factors*. These explain why some projects achieve their target budgets and other projects do not. Here, the quality of projects and campaigns launched, issues of cost reduction and adjusted target budgets, Social Networks and user participation, proximity and social relations, personalised assistance and cultural attachment with the target projects and population, have been identified as crucial elements in explaining success in crowdfunding.
- 3) *Regulation*. The role played by regulation in shaping crowdfunding growth, and the potential for regulatory changes are also important in understanding the potential and limitations of crowdfunding. However, the way in which crowdfunding should be regulated in order to protect investors, regulate taxation and favour harmonisation is not so evident.
- 4) *Public Institutions*. The potential value to, and role of public institutions in favouring the expansion of crowdfunding has been also analysed. Although this role is still very limited, the increasing participation of public institutions favouring the expansion of crowdfunding is likely to provide additional inputs to the decision-making process, innovative public funding regimes and additional legitimacy to public institutions.

5.1 User factors.

Research on user motivation for participating in crowdfunding services (both to pitch a project and to invest or donate money), shows two main spheres of motivation and practice that define participation in crowdfunding:

- 1- Alternative (democratic/philanthropic) Economy. Some people see crowdfunding as a new economic model supported by principles of transparency, cooperation and democratic practices, which threaten the guiding principles of neo-liberalism. Crowdfunding is thought to go beyond typical capitalist models of accumulation, commodification and proprietary production, offering an “alternative” model. People decide to use crowdfunding services for reasons other than earning and profits, putting emotional and ideological priorities first. Donation-based and to a lesser extent reward-based platforms are expected to appeal to and attract this type of crowd users.
- 2- For-Profit Economy. For other people, crowdfunding means business by other means. Crowdfunding is seen as a new efficient way of doing business using the potential of ICTs. The advantages associated with crowdfunding practices (ongoing innovation, creative adaptation, wider diffusion and perception of product newness), are thought to translate into lower investment costs and higher profit margins. Equity and to a lesser extent lending-based platforms are likely to attract this type of users.

However, these should not be seen as mutually exclusive. In many cases the evidence points towards hybrid models. Some people use crowdfunding services in search of profits, yet profits are not everything. Users do value the enhanced ethical (democratic) component of the crowdfunding economy.

5.1.1. Alternative (democratic/philanthropic) economy

Although funds raised by crowdfunding services are still negligible compared to those raised through traditional banks, they are significant enough to suggest the consolidation of a new form of business with its own logic and purpose. Crowdfunding seems to challenge the ethical code of the “homo economicus” who exclusively focuses on maximising-profits by using rational, as opposed to emotional, calculations.

The idea of an “ethical economy” where transparency, fairness, cooperation and solidarity matter is gaining strength among large segments of the population. These changes have increased the importance of non-market and non-proprietary production, which threatens the incumbents of the industrial society (Benkler, 2006). Democratisation in production and organisation has been also underlined. The Information Society is thought to favour a shift from hierarchies to networks organized in a system more radically decentralized than ever before, which allows better coordination, transparency and cooperation (Castells, 2000).

Crowdfunding users seek not only to fundraise for projects or to exchange services, but also to participate in the process of product creation, improvement and diffusion, especially when they perceive that the business model is fair for them (Franke and Klausberger 2008). It is what Surowiecki (2004) called “wisdom of the crowd” and Kleemann (2008) referred to as “working consumers”.

Backers and donors appreciate being part of a venture they identify with. This seems to be particularly the case with cultural and creative projects, such as video games, music or publishing. Crowdfunding adds a sense of democratisation of cultural patronage, establishing new revenues for the creative industries and creating transparency and legitimacy for public funding (Rothler and Wenzlaff, 2011).

Creators and entrepreneurs retain full control of the idea and its implementation. They can test the popularity of a product using just a prototype. If the product resonates strongly with the audience, they may exceed their funding target. Yet, if a project does not succeed, the creators lose nothing more than their time, and they can re-launch a new improved project.

One hypothesis is that 71% of the projects and campaigns launched are based on donation and sponsorship and only 16% are equity for-profits projects (in the USA - ipled¹⁵). Donation-based platforms are the majority worldwide. There are 175 of this kind, followed by reward-based (127), equity (77) and lending-based platforms (36) (Crowdfundinsider, 2013)

Philanthropic organizations tend to be more successful in achieving their funding targets because they are more flexible in maintaining a quality-quantity mix. They put less emphasis on profit making than on quality products or services, even if quality comes at the expense of quantity (Lambert and Schwenbacher, 2010).

Yet, other analysts stress the centrality of entrepreneurship, rather than philanthropy, in the expansion of crowdfunding practices. True donations are only the strongest motivation for 22% of entrepreneurs using crowdfunding services, followed by “active investment” (32%) and “passive investment” (60%). Most people use crowdfunding for “Raising money” (90%), or to “get public attention” (85%) and “obtain feedback for their product and services” (60%) (Lambert and Schwenbacher, 2010).

In the same vein, Steiner (2012) states that what users “get in return” is vital in crowdfunding practices. In his own words, “if you ask for contributions and offer nothing of value in exchange, you will quickly discover why crowd-funding isn’t like running a charity fundraiser. Ultimately, you are selling something, be it advance access to a software product or the chance to appear within a film

¹⁵ <http://ipledg.com/blog/?p=166>.

(cameo)". Therefore, for Steiner, crowdfunding is essentially about marketing because i) having a promotional plan is essential, ii) outreach must be constant and on-going, iii) you are selling yourself as much as any product, and iv) endless advertising is involved.

This may explain why the business-solidarity mix is not growing at the same pace. Crowdfunding is increasingly becoming a viable source of entrepreneurial seed capital to start new ventures. 45 out of the 50 highest-funded projects in Kickstarter have turned into entrepreneurial firms (Mollick, 2013). Although social projects are still predominant, evidence indicates that equity is growing faster than ever (in the USA).

Equity crowdfunding platforms have grown 114%, raising over \$25K+ and are expected to grow at a rate of 63%. Donation-based platforms show the slowest growth in the ranking at 41% (\$676 million raised), while lending-based platforms raised \$552 million and are growing at a rate of 50%. Reward-based platforms are up 78% since 2007 (Crowdsourcing.org 2012).

5.1.2. For-profit economy

Proponents and some research suggest that crowdfunding could be a powerful mechanism for capital formation. It allows significant reduction of financial costs and of the associated investment risks that can be directly applied toward production and marketing costs (Steinier & DeMaria (2012). As stated by Baeck, Collin and Westlake (2012:9) "by giving investors more of a role in carrying out due diligence, and automating more of the funding process, crowdfunding can reduce the transaction costs of getting capital to entrepreneurs, making financing cheaper".

Project managers often receive very useful advice and in some case direct assistance from backers. The backers become an important part of the marketing effort and also of the built-in marketing team, helping to promote the project. Crowdfunding platforms serve as a marketing tool to encourage social media participation and as a forum to get feedback on the launched projects. Fees payable to platforms are considerably lower than those in traditional banking sectors (Steinier & DeMaria, 2012:5).

Crowdfunding allow creators to access funders with an inherent interest in a more personalised product, resulting in greater willingness to provide finance on more favourable terms, while allowing a cheaper process of engagement with geographically dispersed funders and donors (Baeck, Collin and Westlake (2012). Additionally, crowdfunding has the potential to bring about gains in innovation, creative adaptation, higher acceptance, wider diffusion and higher perception of product newness. Crowdfunding users also comment on other people's ideas, therefore creating rich interactions and innovative thinking which are very useful for the entire crowdfunding community (Schwienbacher & Larralde, 2010).

Crowdfunding makes it possible to bypass the intermediaries of a traditional financial supply chain. Money seekers can now bypass banks, venture capitalists, business angels or public financing regimes. These traditional mediators see the rise of crowdfunding as competition or a threat for their business models (Rothler and Wenzlaff, 2011). However, as we shall see, crowdfunding is starting to work with some of the traditional intermediaries, such as business angels and public bodies, which may re-orient the innovative character of crowdfunding toward more traditional ways of financing.

5.2 Success factors

A key issue in assessing the potential impact and success of crowdfunding is to understand why some projects are successful in raising money and others are not. Success is basically about reaching the target budget. It is also crucial to the design of the services themselves, and identification of the support that crowdfunding users may require.

There has been relatively little research on what makes a campaign successful (this may or may not lead to a successful outcome of the whole project). Target budget is however important in explaining success and failure. According to Carr “less is more” in crowdfunding practices, meaning, “that beginning with a modest goal and having a compelling project can reap great success” (Carr, 2012).¹⁶ In his analysis of 16,763 backers in the Role Playing Game sector, Carr concludes that the total amount of money raised was 29% higher (\$834,920) than the target budget submitted (\$646,712), with an average of \$46.51 raised per backer. When separating the successful and unsuccessful projects, the former averaged \$3,483.78, while the unsuccessful ones averaged \$5700.66. Moreover, the former not only raised 679% more than the unsuccessful projects (\$8251.31 for \$1058.88) but also raised 230% more than the initial goal, (i.e. projects aiming to raise smaller amounts of money were more successful in reaching their threshold).

Mollick (2013) concludes that projects (rewards-based only) generally succeed by small margins or fail by large ones. 25% of projects that are funded are 3% or less over their goal, and 50% are about 10% over their goal. Only about 1 project in 9 receives 200% of its goal. In his analysis of Kickstarter, he finds that the mean amount funded of failed projects is just 10.3% of the goal. Only 10% of projects that fail raise 30% of their goal, and only 3% raise 50% of their goal. The average failed project received \$900 in pledges, compared to \$7,825 for successful projects. Therefore “failures happen by large amounts, successes by small amounts”.

Some of these findings have been confirmed by recent studies. By analysing 1,127 cases of technology projects from four different crowdfunding platforms with probabilistic methods, Cordova et al (2013) conclude that success in crowdfunding campaigns seems negatively associated with the project funding goal amount, and positively associated with project duration and with the amount contributed per day. An increase in the project goal decreases the probability of success, whereas project duration increases the probability of success.

There is also evidence suggesting that past cumulative investment positively affects the chance that new investment comes in, so that the larger the volume of investment accumulated by a project, the higher the propensity for others to invest and the better the chance of getting additional funds (Agrawal et al., 2011).

For Schwenbacher & Larralde (2010) the size of the project matters, but in the opposite sense. From their standpoint, financing is more difficult for small projects because the lack of available historical data creates information asymmetries that dissuade potential investors, especially banks and business angels, from funding these campaigns.

Time limit is also important. According to Jones (2012),¹⁷ it takes 3 weeks to get 25% of the funding on average and about 10 weeks to finish the whole campaign with success. This time period is rather long, so the preparation of the whole project and campaigns, including the necessary budget, the activation of social networks etc., must be thoroughly prepared before launching the project. In this sense the role of the managers is vital.

In his analysis on the dynamic of successful projects in the USA (based on Kickstarter), covering over \$237 million in funding pledged to 48,526 projects, Mollick (2013) concludes that success in funding is highly related to the projects' quality level, the number of friends on internet social networks, projects' cultural attachments with underlying cultural products of the geographical area (liking for local) and the nature of the population in which funders operate. Other analyses have confirmed the importance of social networks and social information in explaining patterns of success (Kuppuswamy and Bayus 2013).

¹⁶ The 2011-2012 Report on 150 Role Playing Games Crowdfunding Projects:

<http://www.geekindustrialcomplex.com/articles/crowdfunding-report-part-1>

¹⁷ <http://www.pleasefund.us/blog/article/getting-nerdy-with-crowdfunding-numbers>

Although it would seem that crowdfunding could reduce the role for spatial proximity, geography matters and social relations are still fundamental in crowdfunding initiatives (Agrawal, Catalini and Goldfarb, 2011). Social networks increase confidence and trust, which are always necessary in doing business. As government grants and public investment decrease due to the crisis and the new role that liberal prescriptions attribute to the economic role of the State, the dynamics of social networks constitute a realistic alternative.

Drawing together the insights from these different research studies, it is possible to identify five factors that shape success in crowdfunding:

- 1- The quality of projects and campaigns (costs reduction and target budget)
- 2- Social networks/ users participation. Proximity and social relations
- 3- Personalised assistance
- 4- Knowledge of users
- 5- Localism (the cultural attachment with the target population) versus internationalisation

Studies are starting to address the importance and the conditions under which these factors can be reinforced, but more research, and practice is required.

5.3 Regulation

Policy makers and the industry are facing the challenge of how crowdfunding should be regulated, whether current regulations are sufficient, if they should place restrictions on growth of crowdfunding, or even whether there is enough regulation already. The main argument for examining current regulation in crowdfunding is to improve the current means of raising money in a system that appears not to offer the security of conventional investment models. Regulation is hence analysed on four closely-related topics:

1. Protection of investors/users against fraud
2. Taxation
3. Legislation
4. Harmonisation

5.3.1 Protection of investors and consumers

Three main issues identified relate to the protection of investors and consumers: fraud, delays, and money laundering (which amounts to fraud by third party investors).

Crowdfunding would appear to offer many opportunities for fraud. No credentials are needed to post a project and, once the project has been posted, there are few legal obligations to deliver what the project promised. However, so far fraud has been very rare in crowdfunding practices: delays in delivering the promised rewards or profits constitute the real issue. In his analysis on 381 successful Kickstarter projects in Design and Technology in 2012, Mollick (2013) concluded that fraud is very low and the money pledged to projects that had stopped responding to funders at the date of the research (either due to failure, fraud or other reasons) accounted for less than 0,5% of the total funds raised. Only 3.6% of successful projects can be considered fraudulent in the sense that they stop responding to backers and could potentially have given up on delivering entirely.

For de Buysere et al. (2012) the risk of fraud is high in crowdfunding practices because, unlike venture capital or the business angel investor, the pool of funders has no personal contact and/or real knowledge of the business plan beyond what is presented on the website. The lack of accountability is hence an obstacle. Since crowdfunding platforms are mere intermediaries between entrepreneurs and funders, their responsibility in cases of fraud is lower than it would be for other types of intermediary.

Yet, the lack of physical contact is not necessarily an incentive for fraud, but rather a fear felt by those who believe in the "Fraud Bogeyman" - something like the fear of a "phantom that emerges

from the shadows to steal all of our money via crowdfunding” (Crowdsourcing, Editorial November 22, 2011 and “The Crowd Room”¹⁸).

Other more consolidated experiences in economic transactions over the Internet, mainly selling and buying on platforms such as eBay or Todocoleccion, provide proven good practice in eliminating fraud. Furthermore, social media can be used to prevent fraud, since it allows funders to perform research on entrepreneurs before deciding to invest (de Buysere et al, 2012).

Delays, however, constitute a serious issue. Rothler and Wenzlaff (2011:22) report that each project goes through at least three different transitions that can imply delays of weeks or months: i) funding promise or indication of the intent to support a project, ii) initiation of payment, iii) receipt of the material or non-material rewards.

Crowdfunding implies a time difference that increases the risk of delay. The time span between the initial decision to raise funds for a project and the delivery of the services promised (material and non-material rewards) may explain why the majority of successful projects analysed in Mollick’s (2013) work were late in delivering their promised products.

Another issue of importance in the prevention of risk is related to money laundering. Crowdfunding may serve as a mechanism to launder money. Therefore additional measure to avoid this risk could be considered.

5.3.2. Taxation

The unclear nature of income through crowdfunding puts taxation at the forefront of policy controversies. Crowdfunding is subject to taxation in all the EU Member States through sales tax (VAT), income tax and capital gains tax. Yet disputes on taxation persist, mainly between those in favour of tax harmonisation to avoid difficulties in investing for reasons of differences in national legislation (capital requirement, owner protection, transparency, accountability and investor protection) and those against tax harmonisation, who prefer tax competition instead.

Taxation in crowdfunding is complex by nature. The income invested in funding a project will be differently assessed if it belongs to a company or a charity, if investors are seeking profits or if they are donors looking for non-material rewards. While the project initiator is often one individual or a group, the project tends to benefit a variety of entities with different tax status. Similarly, rewards are often a mixture of investment, donations, services and goods, all of which are charged tax differently. In some countries, certain economic sectors have special tax systems to foster crowdfunding activity (Rothler and Wenzlaff, 2011:28).

All in all, money raised by crowdfunding can be taxed in at least four ways: sales tax, income tax, equity and capital gains tax. Much of crowdfunding is pre-selling, so that contributions (funds to raised by a project in exchange for a saleable product) are susceptible to sales tax. Additionally crowdfunding generates income for creators and entrepreneurs, which is unlikely to be exempt from income tax. The issue of capital gains is clearer for financial rewards, since all funds are investment and profits (Dailycrowdsource, 2012).¹⁹

Social security and other social charges are not well defined in crowdfunding services either,

¹⁸ <http://www.thecrowdfundingrevolution.com/2011/11/fraud-bogeyman-of-crowdfunding.html> and <http://www.crowdsourcing.org/editorial/crowdfunding-fraud-the-nfl-does-crowdsourcing--more---the-crowded-room-podcast/19380>

¹⁹ <http://dailycrowdsource.com/crowdsourcing/articles/opinions-discussion/1005-understanding-crowdfunding-taxes>

especially if projects creators and backers are non-resident in the platforms' country of origin. Moreover, the fact that platforms are not responsible for the money raised through their services, creates a grey area where it is difficult to apply taxation law.

Taxation mechanisms, such as the reduction of corporate taxes and the tax burden for companies operating in particular sectors, are frequently used to promote the development of those economic sectors. This is particularly relevant in a sector as new as the crowdfunding economy.

5.3.3. Legislative Uncertainty

Lack of legislation and/or two-tier legislation is considered to be the cause of distrust among entrepreneurs and investors. Protection of projects and ideas is a handicap in crowdfunding practices. Creators expose their ideas to others, who could copy them. Legal protection is not guaranteed by all platforms and there is no patent or copyright protection in crowdfunding practices at this early stage of development (see Section 5.3.1.)

The fact that companies have to comply with EU legislation and also with each Member State's interpretation of these laws is certainly an obstacle for the consolidation of crowdfunding companies. Furthermore, there are idiosyncratic or country-specific laws to regulate financial products and markets that reinforce friction among different legislative levels.

Current European legislation regulates prospectus regulation, intermediaries and shareholders. Yet, despite this threefold legislative regime, there is no specific European legislation on crowdfunding and until recently, only the UK had approved legislation that specifically addresses crowdfunding. Among the reasons behind this lack of harmonisation, Chapman (2012) points to the widespread concern about allowing unregulated investment products to reach the general public.

"There is a concern that retail investors have been misled in the past and this has affected the authorities' approach to crowdfunding. Nobody's taken it up yet as being good for micro-enterprises, which I think has been the flavor in the U.S. and possibly what has underpinned crowdfunding gaining in Italy more recently. I suspect that like many things, it needs some political backing. But I think the words 'retail' and 'investment' make people (and regulators particularly) worry that it could create the next mis-selling scandal and the U.K. public has had quite a number of problems with investing in products that they don't understand already" (Crowdsourcing.org- Editorial)²⁰.

5.3.4. Harmonisation

De Buysere et al. (2012) rightly put forward the most important challenges and limitation regarding regulation and legislation in crowdfunding services. The existing European legislation allows Member States to implement national legislation for campaigns below the €5 million threshold, which, in their view, has resulted in different regimes with different prospectus and exemption for investment.

This plurality of legislative frameworks favours different national views as to what are considered acceptable transition structures. This alongside the fact that start-ups choose simplified company type, which limits their capacity to offer equity to new investors, and the reclaimable funds they take on (accepting reclaimable funds requires a licence as a credit institution, the conditions for which platforms are unable to meet). This justifies the need for the creation of a European harmonised regime.

In their view, current European Legislation does not promote efficiency and transparency in crowdfunding practices, because it is designed for incumbent actors.

²⁰ <http://www.crowdsourcing.org/editorial/a-cloudy-forecast-equity-crowdfunding-in-europe-part-1/20692>

5.3.5. Links to public institutions

Although literature on this issue is very scarce, Rothler and Wenzlaff, (2011:5-11) provide a detailed account of the different potential and existing links between crowdfunding and public institutions. The authors conducted extensive online research with eleven platforms and ten experts in the crowdfunding industry, who responded to a survey on the basic issues of the current debate on the future of crowdfunding.²¹

- The success of a crowdfunding campaign can influence the decision-making process on whether to provide public backing to a project. To avoid the risk of populist decisions, this should be only one of several criteria guiding public funding decisions.
- Public institutions could set aside a certain sum and co-finance crowdfunding projects through a matching grants model, if the crowd also contributes a requested sum. Which projects are funded is then the decision of the crowd.
- Crowdfunding could also provide an alternative to the traditional public funding regime where money seekers send complicated applications to funding bodies like the European Commission or national authorities, which then decide in a top down approach.
- Crowdfunding could be integrated with traditional public funding. One could imagine a system where project initiators have to prove that they have a community behind them willing to support their project financially and in other ways.
- Crowdfunding enables a strengthening of the linkages between a pitched project and its target group and provides an indication of the sustainability of the project. Even the project outline could be refined through a crowd-sourced process as many platforms allow or even encourage people to contribute their talent or ideas to the project. Starting a crowdfunding project means starting a communication process. Establishing communication around a project is the kick-off point for the dissemination of project results at a later stage.

Public institutions are slowly becoming aware of the untapped potential of crowdfunding and are trying to reduce legal barriers for entrepreneurs. There are some good examples of how public institutions are increasingly supporting crowdfunding platforms, especially in the context of the current crisis, by putting crowdfunding at the forefront of public policy initiatives. In April 2012, President Obama signed the JOBS Act (Jumpstart Our Business Start-ups Act) to help small businesses to raise money by easing various security regulations through exemptions, which is expected to foster crowdfunding practices. This act aimed to help small businesses raise money in times of economic crisis. It also allows companies to engage in early-stage funding without making certain onerous disclosures to investors.

In December 2012, the city of Cincinnati announced a partnership with a leading crowdfunding platform to help qualified small-businesses gain access to loans of up to \$400,000 made by the city. Similar initiatives have been launched in Geneva and Lausanne, (the 100-days.net web). The regional government of Andalusia in Spain has approved a pioneering initiative, which among other things allows tax reduction for people who contribute to a crowdfunding campaign.

²¹ 1- Which areas of financial regulation in your country were relevant in setting up the crowdfunding platform?
2. Have you been contacted by the financial supervision authority of your country to give details about your business-model?
3. Have you partnered with a financial institution e.g. a bank or a payment provider in order to fulfil certain requirements of financial regulation?
4. Do you know about any cases of prosecutions against crowdfunding schemes based on violation of financial regulations?
5. Which legal barriers exist for cross-border access to your platform, especially when it comes to creating or funding a project?
6. What recommendations for regulation and policy developments do you propose for the further evolution of crowdfunding schemes in Europe?

Two of the five platforms analysed in this report are forging very innovative connections with municipalities in their regions of origin. The German platform *LeihDeinerStadtGeld* advises municipalities and municipal companies on community-based funding models and *Crowdculture* (Sweden) is financing cultural initiatives not only from private but also from public funds.

To summarise, the role of public institutions in promoting the expansion of crowdfunding practices is still very limited, but public institutions are starting to be involved, in fields such as regional development. Public funding or involvement could provide:

- Additional inputs to the decision making process,
- Innovative public funding regimes
- Additional legitimacy for public institutions
- Investment targets based upon criteria of sustainability

6. Case Studies

6.1 Symbid

Name	Symbid is a Dutch crowdfunding company founded by Robin Slakhorst and Korstiaan Zandvliet
Website	http://www.symbid.com
Region	The Netherlands
Start-up date	2011
Date of data collection	July 2013
Names of people interviewed	Korstiaan Zandvliet
Platform figures	15 projects were fully funded with a total value of €680,000. Seven of these propositions were funded in the first half of 2012, with a compounded value of €410,000 or an average of €58,500 per idea. The total value of all ideas (including the not yet fully funded ideas) was over €1,000,000 (as of January 2013).

6.1.1. User factors (motivations)

Symbid is an equity-based crowdfunding platform, whose main objective is to favour “*ownership for everyone: find capital or become owner in exciting start-ups or established companies*”. This company is the place to be for those who see crowdfunding as a “profitable economic sector” in the new framework of the digital market.

This platform has various plans to create a secure environment for business and more efficient financing practices, which are expected to increase efficiency in the whole financing process. Symbid offers various online tools and services to create a **secure environment** for financial transactions, and investors' control of investment, helping the crowd to become shareholders and guaranteeing refund of investment if the preferred project is unable to reach its target budget.

Many of these factors have **increased the efficiency of crowdfunding services**. Security in transactions, financing limits and refund reduce the risks associated with investment, making investment more attractive. They have also allowed cheaper finance services than traditional banks and increase profit margins.

Symbid is very innovative in providing incentives for participation. It offers an “**affiliate programme**” for those willing to bring investors and entrepreneurs to the platform and share the fees generated by their transactions. It is a kind of “user-hunter” agent, which offers its services to users' social networks. The affiliate can get commissions in two ways: firstly, when a new user makes a deposit through the affiliate partner and secondly, when a fully-funded proposition is posted by a user via the affiliate partner.

6.1.2. Success factors

Success in crowdfunding is about turning ideas into reality. Literature on success in crowdfunding agrees that *the quality of projects and campaigns* matters in increasing the chance of success. Symbid has developed three services to help projects and campaign gain in quality:

- 1- A portal called “**Crowdfunding Campus**” helps entrepreneurs through the crowdfunding process. It provides a step-by-step guide to developing a business plan, an informational video, and advice on how to effectively reach potential investors. Symbid also provides tips

and tricks to get the most out of the crowd, and to help set up campaigns. Symbid also facilitates Q&A sessions and status updates.

- 2- Entrepreneurs and their investors are directly connected via the platform. Symbid provides online collaboration between entrepreneur and investors via an **"Inner-circle"** that encourages engagement. Entrepreneurs and investors may join forces through their secured **online collaboration community** to actively support the venture along a successful and profitable growth path. Using various tools, entrepreneurs and investors monitor the company's progress and interact with one another. In addition, individuals have the ability to transfer their stake in the company to other internal or external investors.
- 3- Public pitches need to comply with requests for information such as profit and loss statements, business plans, and pitching videos. **Symbid checks propositions for legality and accepts them on the basis of affinity.** Affinity is thought to increase **involvement** and **engagement** with the projects. There is also a screening process before any idea is accepted on the site. A public pitch also needs to comply with requests for information about creators' motivations.

Symbid understands **user participation** as a pre-condition for success. Participation encourages trust and cooperation, which translates into a **learning community** in which users exchange know-how, information and innovative practices to improve the quality of the projects. Participation also increases the size of Symbid's **social networks**, with the subsequent positive effects on success. The idea of reinforcing a *community of users* has been repeatedly reported as a priority for Symbid.

This company strives to guarantee participation not only during the financing process, but also when the project is launched. Entrepreneurs can raise funds in two ways: through pledges and through equity. Once the target capital is reached, Symbid packs all investors into an investor cooperative, which behaves as a single shareholder in the legal entity of the entrepreneur. Each investor participates in a single legal business. The entrepreneur transfers the agreed-upon percentage of equity as indicated on the Symbid page.

However, the level of **optimal participation** is controversial. Symbid promotes **affinity** with the principals of the company as a way to attract **"the right participants"** rather than participation as such. All propositions, projects and campaigns are checked for legality and are accepted on the basis of affinity. In this sense, affinity acts as a filter to participation.

Investment thresholds are also tools to regulate participation. Maximum investment limits encourage massive participation, whereas no limits increase the risk that few investors take over the project, thus going against the logic and principles embedded in crowdfunding. Symbid's manager expresses some doubts about setting up thresholds for investment, here understood as a regulator of user participation. In his view, it is true that some limits are necessary to meet basic crowdfunding principles of participation and involvement, but the wrong threshold, especially as regards maximum investment, is thought to hamper the efficiency of crowdfunding.

One of the most salient improvements attributed to crowdfunding services is their capacity to provide financing at **low cost**. Indeed, crowdfunding is considered a **low-cost way to access capital**, which allows more people to create and invest. In the interview, Symbid's manager confirmed this perception: *"Cost reduction in accessing capital must remain a priority"*. Using Symbid is free for start-up entrepreneurs and investors. Existing companies and projects pay a small fee (€250 exclusive of VAT) for their registration. In addition, 1% of the funding capital must be in place before a project appears on the website.

Personalised assistance. Symbid feels obliged to make sure that due diligence is checked according to standard investment models. Investors have an *investment manager* who takes care of

funds transferred by customers, and who also provides some reporting back to investors. Symbid plays no part in the investment but uses these reports to promote trust and involvement and keeping customers satisfied.

Good knowledge of Symbid's users. Having a good knowledge of your current and potential clients is vital for improving the levels of success. In this sense, the company has a good understanding of its users and motivations for using Symbid services, which helps to expand and improve Symbid's services. Users tend to be highly educated Dutch (70%) males between 30 to 45 years of age, with a background in finance or entrepreneurship. In 2012, 85% of retail investors had a portfolio with an average value of €270, up from €170 in 2011.

Internationalisation is very important for Symbid as well. In fact, 35% of investors are from other EU countries. The Dutch market is too small to be profitable, so internationalisation is crucial in its business model. Symbid has an EU banking licence, through its finance partner Intersoft. This allows EU investors to invest in Dutch companies. Foreign entrepreneurs must set-up a legal entity in the Netherlands.

6.1.3. Regulation

Symbid's emphasis on security and efficiency helps to prevent fraud. The idea of creating a Symbid community arose as a means of dealing with some of the most evident components of fraud, namely lack of accountability, information and credentials. The sense of belonging under principals of mutual interest allows creators to decide on the type of funders they want and the types of project that best respond to investors' interests, which reduce the risk of fraud.

Symbid's manager is aware that social due diligence on a massive scale makes fraud difficult and Symbid has had no problems with fraud to date. Fraudulent behaviour by the entrepreneur is covered by the terms of use and is subject to criminal indictment. Moreover, money streams are clearly traceable through banking licences and there are mechanisms in place to prevent money laundering and terrorism financing.

Regarding taxation, users pay taxes on gains from capital assets. All dividend payments are registered and investors are notified of a pay out by letter. They then have to sort out the specifics with their local tax authority. For the pre-sale modules, the taxes are taken directly from the amount raised. For the equity side, Symbid only works with Dutch limited entities, so they take care of declaring taxes themselves.

Symbid is in favour of European harmonization for two main reasons.

- 1- European legislation could create a *sustainable ecosystem for funding entrepreneurship*. With several legislative systems acting on creation, investment and donation, is not optimal for crowdfunding to grow. Internationalisation would encourage the development of a clear legislative framework to ensure creation and investment at European level.
- 2- Additionally, the implementation of policies under a common European legislative framework would take away *arbitrary opportunities to defraud the system*.

6.1.4 Relations with public institutions

For Symbid, public institutions should help to expand crowdfunding practices by allocating funds for those projects that did not manage to raise enough. They should fund ideas that have crowd support of 50% so that they achieve 100% of the target budget. If private funds do not cover the target budget, then public funds can cover the shortfall.

This is certainly a view of public ***institutions as a complementary mechanism of financing***. The main idea is they should become investors in projects that are under-funded. Administrations should not assume the principal role in generating economic activity and employment, but rather the role of fuelling the existing economic initiatives.

For Symbid's manager, this not only benefits the crowdfunding economy, but also the public administration itself. Using public funds for under-funded projects is also a way of **innovating public policy practices**, providing **inputs to decision making processes** and favouring a **democratic allocation of funds**. These become *selection mechanisms* which determine where and how much to invest. *"The administration does not have the last word"*.

6.1.5. Future challenges

The challenge now is to persuade more people to use Symbid services (participation) and to further deepen *"ownership for everyone"*. Although Symbid is successfully harmonizing the efficiency of their business model (profits) with reinforcing transparency and increasing participation, there may be some trade-off between profits and massive ownership in the near future.

6.1.6. Transferability and scalability

The most significant added value Symbid offers is its abundance of high-quality services to increase participation and the chance of success. Those services that aim to connect creators and investors to gain in transparency and efficiency are especially interesting. The idea of creating "learning communities" also deserves special attention. These activities, where users come into contact with each other, improve the efficiency and transparency of crowdfunding practices

Table 3: Summary of findings

		User Factors (Motivations)	Success Factors	Regulation	Public Institutions
Symbid	Objectives	<ul style="list-style-type: none"> - Profits - Ownership for everyone 	<ul style="list-style-type: none"> - Raise profitable projects 	<ul style="list-style-type: none"> - Prevent fraud - Harmonised tax and legislation - Democratic allocation of funds 	<ul style="list-style-type: none"> - Allocation public funds for projects insufficiently raised - Transforms public institutions into investors
	Factors	<ul style="list-style-type: none"> Secure Businesses Efficiency 	<ul style="list-style-type: none"> - Quality of projects - Social Networks - Personalised assistance - Knowledge of users - Internationalisation 		

6.2 One Percent Club (1%CLUB)

Name	One Percent Club
Website	https://onepercentclub.com
Region	The Netherlands
Start-up date	2008
Date of data collection	May 2013
Names of people interviewed	Marianne Gybels
Platform figures	444 launched projects, achieving €929,673 and 6,546 hours spent in 70 different countries

6.2.1. User factors (motivations)

The 1%Club is a non-profit donation-based crowdfunding platform, which was founded by Anna Chojnacka and Bart Lacroix in 2008. Their mission is *“to give people direct access to the necessary means to allow them to structurally improve their lives”*. The 1%Club strives to finance small-scale development and sustainable projects by connecting ideas in developing countries with money, time and knowledge from the rest of the world.

The name “one percent” sums up the philosophy of its business plan, that is, to convince people to offer 1% of their time, knowledge and income to a development project of their own choice. This is one of the most remarkable features of 1%Club. This platform is introducing new crowdfunding participation practices which allow people to donate not only funds but also time and knowledge.

The 1%Club is designed for those who see crowdfunding as an “Alternative Economy” made up of people sharing a distinctive ethical code based upon cooperative and philanthropic ideas. *“The 1%Club is the place where you can share a little and change the world, in your own way”*.

Projects have to comply with several conditions laid out in the 1%Club's ethical code. The projects should be focused on ***fighting poverty in developing countries***. They should contribute to the realisation of the ***millennium goals*** on a small and concrete scale. The project is a ***unique assignment with time limits which ends with clear project results***. The project owner keeps the Club ***informed on the project's progress***. The 1%Club does ***not fund general exploitation costs of the organisation requesting funds***.

Additionally the 1%Club aims to support ***sustainable projects*** which stimulate the self-reliance of individuals and improve their standard of living. The preference for sustainability offers a kind of sub-specialisation in development and cooperation practices. ***Projects are conducted by local citizens*** who have much more detailed knowledge of their daily lives. This changes the direction and logic of cooperation: *“We see possibilities where others see problems. We see people with ideas, instead of people in need. We don't pity, we enable. We don't help, we ignite.”*

The possibility to ***donate time*** is distinctive of the 1%Club. It is the only analysed platform which allows users to offer time, as well as knowledge and money. Time constitutes therefore an interesting mechanism of participation that allows more citizens to get involve in crowdfunding. The 1%Club is, to some extent, importing strategies and schemes from time-banking, as these allow more channels for participation.

6.2.2. Success factors

The 1%Club's manager agrees with literature that connects high quality projects and success. This platform carries out several plans to help creator and entrepreneurs to improve the **quality of projects and campaigns** that will be subsequently launched by citizens in rich economies.

The 1%Club's central priority is to help local citizens design their own projects and campaigns, because *"No one is good at everything. This includes the project initiators at the 1%Club. Sometimes their projects need some accountancy know-how, a fresh new logo or a marketing strategy in order to take off"*.

The company also offers advice from its own experience on how to develop an idea. Donors can browse through the projects and check whether they need additional skills and expertise to improve. They offer highly-skilled technical knowledge and time for free, which is very useful in countries where technical specialisation is scarce and of poor quality. This is the context in which **time and knowledge become tangible and interchangeable products** for cooperation.

Technical assistance acts as a selection mechanism to filter **"smart ideas"**. The 1%Club believes an idea is smart when it has a big social impact, even though the project itself might seem small. In addition, projects must be concrete and have a clear start and end. They will need on/off investment to make them self-sufficient and sustainable in the long run and should be managed and owned locally in developing countries.

The 1%Club promotes **users participation**. It offers the opportunity to learn from and work with other projects (**learning community**). Projects can view reports on the received donations online. Moreover, the 1%Club's staff and creators discuss together how to evaluate and improve the submitted ideas. They follow the agreed process, engage in regular feedback sessions, and participate through sharing expertise and knowledge. Then, every creator brings three discussants (ambassadors) to evaluate and confirm the reliability of the project.

Although this company aspires to reach the largest possible number of donors and widen the scope of **social networks**, it also promotes **affinity-based participation**. Filters are on projects rather than on donors. Nevertheless, the 1%Club establishes limits on donations in order to guarantee that ideas remain in creators' hands. If a company wants to make a large donation they are requested to split it over various projects. Funding automatically closes when the threshold is reached.

The 1%Club offers the possibility of **supporting projects more structurally** by sharing time, knowledge or donations every month. Donors can do this in two ways: first, they can donate to one project every month until it achieves its target. When this happens, a donor can choose a new project to support. Second, donors can donate every month to the top 3 most popular projects.

This company's manager considers crowdfunding a **low-cost way of accessing capital**. Cost reduction is necessary to improve efficiency and attract more creators and donors. Creating and launching a project is free in the 1%Club, although it charges a 5% service fee for donations from businesses and companies.

Personalised assistance. The 1%Club offers coaching and tailor-made advice before and during the crowdfunding process.

Knowledge of 1%Club's users. The Manager provided general information about their user profiles. They are highly-educated young professionals between 25 and 35 years old. The average sum donated is 23€. Most members like to make small donations to multiple projects rather than a big donation to one project.

Follow-up services to check the sustainability of the funded projects in developing countries are essential for the 1%Club. This priority is embedded in the 1%Club's main objective, namely to keep donors up to date on a project's progress by sharing blog posts, photos and videos, once a project has been launched.

Internationalisation is not only important, it is the very essence of this platform. The organisation, structure, strategies and results are embedded in the new logic of a globalised world in which previous patterns of aid and cooperation are put into question.

6.2.3. Regulation

There have been no known cases of fraud in the 1%Club so far. **Affinity** with the platform's purposes and principles (ethical code) protects it against fraud. This affinity and also the **small target budget** required to launch a project act as disincentives against fraud. The amount of money circulating in each project never surpasses a modest sum, which reduces the attractiveness for defrauders. For project owners in most of the target countries, financing above €5,000 would not be feasible. This also reduces the risk of fraud.

Yet the 1%Club is aware that risks exist for both sides: recipients and donors. This platform is a non-profit organisation, whose donations are tax deductible. This may encourage fraudsters to use donations as a way of money laundering. The 1%Club's manager is also vigilant as regards fraudulent utilisation of donations in third countries.

As it is a non-profit organisation, donations to projects presented on the website are tax deductible. The Club is not in favour of taxing donations because this could discourage donors from actively participating in projects.

The maximum investment is €5,000 for each project that qualifies as a smart idea with a social impact. This means that both non profit and social entrepreneurship ideas can qualify for donations.

Generally speaking, legislation tends to be an issue for crowdfunding services, and it is especially complex for donation-based platforms since they are under national, European and international legislation.

All in all, the 1%Club's manager is not against legislation as such. He stresses the necessity for clear rules and friendly legislative frameworks, but these are not always in place in developing countries. In fact, the Club's manager said that legislative difficulties had limited the expansion of crowdfunding to these countries on several occasions. In countries where crowdfunding is illegal, 1%Club prefers no legislation rather than restrictive or anti-crowdfunding legislation.

6.2.4. Relation with public institutions

"In Egypt and Ethiopia crowdfunding is forbidden, so we cannot operate legally in these countries. Therefore crowdfunding needs an institutional friendly environment to be efficient and avoid fraud" (1%Club's manager)

The 1%Club aspires to be a means of **bypassing or overcoming the externalities associated with institutionalised bureaucratic procedures for both recipients and donors**. The 1%Club's manager claims that the Internet has set in motion a big cooperation system where money for cooperation can be better spent and the sustainability of launched projects can be reinforced.

There are good reasons for this aspiration. The 1%Club is "suffering" the consequences of working with multiple regulatory and legislative frameworks (local, national, European, international) in

countries with different political traditions. In these circumstances, the relationship with local institutions in developing economies is frequently fraught with difficulties.

The 1%Club recognises that the world is radically changing and so is aid and cooperation. These changes increase the complexity of working at multiple institutional levels. The 1%Club would like to see public institutions make life easier for start-ups and promote efficient cooperation among recipient and donor countries, through a friendly and more efficient institutional environment for crowdfunding services.

6.2.5. Future challenges

The challenge for the 1%Club is to explore the potential of equity and rewards for improving efficiency in cooperation. Although there is no doubt that equity/rewards and cooperation have their own logic and practices, both share a sense of belonging to the new socio-economic environment of the Information Society and the Network Economy. This new framework opens new windows of opportunity for a redefinition of certain managerial strategies to ensure the sustainability of platforms.

This is not the same as suggesting a progressive unification of crowdfunding services. On the contrary, it is quite possible that the types of investment (e.g. equity-lending, etc.) continue to play an important role in conditioning motivation and strategic options for each platform. Nor does it mean that cooperation platforms are safe from pressures to convert to pure business.

6.2.6. Transferability and scalability

The 1%Club is not just about raising money for cooperation, but also about providing efficient solutions to the puzzles associated with aid and cooperation in poor economies. International institutions dealing with cooperation could apply this logic and experience to improve their policies, by making use of the following ideas:

- 1- Transforming **time and knowledge into tangible and interchangeable products** can positively affect the quantity and quality of cooperation policies.
- 2- Financing **projects designed and conducted by local citizens** in developing economies may substantially change the direction of cooperation from the current logic of patronage to a new framework of mutual interest.
- 3- Supporting **sustainable projects** in developing economies may encourage stable patterns of cooperation, which goes beyond the immediacy of current aims and cooperation policies.

Table 4: Summary of findings in relation to literature

	User Factors (Motivations)	Success Factors	Regulation	Public Institutions
1%CLUB	Objectives - Donations - Awareness	- Fund sustainable anti-poverty projects in third countries	- Prevent fraud - No taxation for cooperation? - Friendly legislative contexts	- Overcome bureaucratic externalities in developed and developing countries. - Transforms public institutions into investors
	Factors - Ethical code - Sustainability - Time/knowledge are exchange products	- Quality of projects - Social Networks - Personalised assistance - Knowledge of users - Inter-nationalisation	- Affinity and small donations to avoid fraud. - No tax for donations - Inclusive legislation	- Efficient cooperation - Pro start-ups policies - Good practices with public institutions

6.3 Verkami

Name	Verkami
Website	http://www.verkami.com
Region	Spain
Start-up date	2010
Date of data collection	June 2013
Names of people interviewed	Jonas
Platform figures	1,503 projects funded with a compound value of €7,220,000 and 183,434 contributors. The success rate is 69.91%

6.3.1. User Factors (Motivations)

Verkami is a reward-based platform founded in Mataró (Barcelona) in 2010 by a father and his two sons: Joan, Adrià and Jonàs Sala. Verkami is a neologism in Esperanto meaning "creation lover", which indicates the central importance of innovation in Verkami's working model. Verkami's main motivation is *"to put together interesting projects, creators with innovative ideas and patrons willing to make them come true. We share the passion for creativity, art and research, and being able to make small manifestations of the things we most love come true is what motivates our work"*.

Verkami is the platform with the highest success rate in the Spanish crowdfunding market. Several campaigns have translated into best-selling books at prestigious cultural events (Sant Jordi Festival in Catalonia), documentaries and theatre plays, reinforcing the connection between innovation, success and sustainability.

This platform could be classified between Symbid (equity) and the 1%Club (donation). Contributions to Verkami are neither profits nor donations because this platform is not particularly interested in equity or donation initiatives unless they have **added creative value**. They have managed to help fund equity projects, ranging from making artisan beer or olive oil to designing software packages, but always emphasizing creativity and innovation.

The **secure environment** for exchange is highly dependent on **trust and cooperation** in Verkami. The fact that this platform does not seek to maximize investment returns may naturally favour a safer space for financing. Trust seems to operate more fluently in reward-based contexts in which the threat of legal action is rare. This is not the same as denying the existence of organizational mechanisms to avoid uncertainty. As discussed below, this company recognises the necessity to set up clear legislative mechanisms to avoid fraud. However, they prioritize self-reliance and responsibility rather than the use of legal action.

This is the reason for **self-reliance and responsibility** being Verkami's main company strategy. Creators are wholly responsible for their promises because they have much to lose if they break them: reputation, supporters, legal actions etc. If they fail to meet their commitments, the company must return the contributions received in full, reducing incentives for fraud.

6.3.2. Success factors

Quality of projects

Verkami supports quality, creative and innovative projects. It carries out a review of the presented projects before they are published. This **selection process** is thought to help the company maintain its creative benchmark. The company gives creators feedback on how to present their propositions in a clear and attractive way.

Verkami also advises users on legislation and tax and how to present the project. For this company there are three basic principles in preparing a project: a properly adjusted target budget, a clear specification of the levels of contribution needed to succeed and an evaluation of what fun and smart rewards will be given to patrons in return.

Sometimes Verkami's staff will also contact creators to modify certain weak or poor aspects they come across before the project is approved.

User participation

User participation in Verkami is more about expanding social networks than about creating learning communities, although users can also give creators feedback through different tools (Blogs, question FQA). *"Success depends on word of mouth and relies on patrons to make that happen".* Patrons are expected to publicise and recommend the project via email, Facebook, Twitter, etc. *"You can give creators feedback through the project's blog or ask questions in the Q&A section to help him/her address things he/she perhaps wasn't aware of. But especially, you can help by sharing it with your friends and family and by getting them involved".*

The use of investment thresholds as a tool to control participation is not an option for Verkami. Once creators have set up the level of contributions and rewards, Verkami's manager does not see the need of establishing any investment threshold for his crowdfunding model. The different levels of contributions allow patrons to choose the projects that fit their budget best.

The risk that a few investors could take over a project, thus breaking the principles embedded in crowdfunding, is not very likely since small investments are encouraged and guaranteed in Verkami.

Personalised assistance

*The selection process acts as a form of **personalised assistance**.* Verkami's administrators review projects on the basis of an application form filled in for each one. They give feedback and provide technical assistance to improve the projects and also advise clients on tax considerations (see discussion below).

Knowledge of Verkami's users

Most people using Verkami's services have the following profile: young, highly educated and with good ICTs skills. Yet new profiles are gaining importance as Verkami develops and gains influence and social impact. New entrants are also older consumers, less educated, mainly creators and patrons.

Follow up

This platform does not follow-up to check the sustainability of the projects launched. Once creators and patrons agree to launch and finance a project, Verkami's economic and legal obligations end and the responsibility passes to the creators and patrons.

However, Verkami's manager expressed a genuine interest in knowing what happens to the projects once they are launched.

Internationalisation

This is also a priority for Verkami. Anyone in the world can pitch or fund a project as long as they have a bank account, and although Verkami's ethical code blocks projects that are offensive, violent or in bad taste. Projects cannot be illegal or break the law. Any project that fulfils these ethical requirements can be launched or funded by anyone from anywhere.

6.3.3. Regulation

There are no known cases of fraud in this company. For Verkami's manager, the **platform type** is **highly related to the risk of fraud**. In his view, there are more problems in equity-based crowdfunding platforms, where profits are more apparent, than reward or donation platforms in which engagement and solidarity significantly limit the expansion of corruption.

Moreover, the **selection process** plays a role in reducing the risk of fraud. Since this company's staff verify the affinity of the presented projects with Verkami's mission statement (innovation in cultural sectors), the risk of fraud is significantly reduced. This selection process and the small funding requests (target budgets) are considered the best antidote against fraud.

Yet Verkami is aware that fraud is a possible risk which could affect the sustainability of crowdfunding practices. Although **trust and self-reliance** have been evoked as a guarantee against fraud, the use of legal action is an option if creators and entrepreneurs do not deliver their promises. Verkami has been adapted to existing legislation.

The problem is that there is **no specific legislation on crowdfunding** services in Spain and the EU as such. This causes **uncertainty** because people are not sure if their contribution is a donation or an investment, whether they will be taxed and, if so, how.

Something similar applies to project owners. Sometimes creators optimistically launch projects without considering the implicit and explicit obligations embedded in financing practices.

Regarding taxation, Verkami is in favour of **tax harmonisation at EU level**, as this would clarify the situation and tax obligations of all parties concerned. However, he is also in favour of tax reduction for those projects that have an undeniable, verifiable social effect.

It is important to underline that most projects shown in crowdfunding platforms are start-ups, which should be treated with special care for their positive effect on economic growth and job creation. This is especially true for Spain, where high rates of unemployment coexist with a small innovative sector of activity. **Tax deductions for innovative ideas** with economic effects are crucial for Verkami.

6.3.4. Relations with public institution

Verkami's manager does not have a clear opinion on what role public authorities should play in the development of digital services. On the one hand, the role of the public administration in the promotion of crowdfunding services is considered positive because **it brings public money into crowdfunding services**.

On the other hand, there are also associated risks. Lack of investment is considered a serious handicap and public institutions could **become investors and patrons**. However, when public institutions carry out economic activities, **clientelism and corruption** can constitute a serious obstacle for the development of the crowdfunding market.

Therefore it is very important for Verkami to have a **clear code of good practice** that engages both crowdfunding agents and governments to avoid such risks.

6.3.5. Future challenges

The challenge for Verkami is to evaluate the limit of reward-based platforms in the near future. Crowdfunding is in the early stages, which means that reward methods could lose their attraction as other formulas based on profits and donations consolidate. Crowdfunding platforms could be

reduced to mere retail locations, where the role of patrons is just to buy products, as is the case in most online purchase websites.

6.3.6. Transferability and scalability

The possible limitation of a reward-based platform can become an advantage if channels to ensure continuous innovation are established. This is the case with Verkami. Emphasis on innovation is one of the most remarkable Verkami's feature and an added value that makes this platform a leader company. A key element in ensuring innovation is the selection processes. This is a fruitful method of efficiently connecting ideas and funds in reward-based platforms.

Table 5: Summary of findings in relation to the literature

	User Factors (Motivations)	Success Factors	Regulation	Public Institutions
Verkami	Objectives - Rewards for innovative projects	- Raise innovative projects in cultural sectors	- More fraud in equity - Harmonised tax - Legislation for crowdfunding	- No clear view of the role of public institutions. - Transforms public institutions into investors
	Factors - Creating added value - Secure business trust - Selection process	- Quality of projects - Social Networks - Personalised assistance - Knowledge of users - Internationalisation	- Selection process - Trust and self-reliance - Tax reduction for start-up	- Avoid clientelism - Good practice code with public administration

6.4 Crowdculture

Name	Crowdculture
Website	http://crowdculture.se
Region	Sweden
Start-up date	2010
Date of data collection	May 2013
Name of people interviewed	Max Valentin
Platform figures	There are currently 16 cultural projects and 3,789 users in the system

6.4.1. User factors (motivations)

Crowdculture is a Swedish platform launched in 2010 by Fabel Kommunikation in collaboration with cultural producers, cultural consumers and the research laboratory Swedish Institute of Computer Science (SICS). Its main objective is to *connect social capital with economic capital by funding cultural projects through a combination of crowdfunding and public grants*. This is the real Crowdculture hallmark, namely to gather both private and public funds to promote cultural activities.

This platform is designed to satisfy the aspirations of those who see crowdfunding as an alternative (democratic) economic model, which is increasingly achievable through the socio-economic opportunities facilitated by today's technical tools. In this sense, this platform is an example of a **hybrid platform** that brings together private initiatives in the cultural sectors, private supporters and public funds under democratic practices.

Crowdculture allows people from several Swedish cities and regions²² to have a say in their cultural investment. This platform provides a leverage effect whereby members' votes control the distribution of contributor funds, triggering bottom-up initiatives that favour **democratic practices in financing**. In Crowdculture's own words: *"It is the members' voices that control where the public money goes. Once a member votes on a project, it corresponds with money from the public pot. The correspondence between public and private financing depends entirely on how strong members support cultural projects"*

The size of individual donations has no influence in the selection procedure. This reduces the risk that big companies could control the selection process and public grants. Crowdculture is particularly sensitive to this issue. Public money goes to those projects which attract large support. Citizens participate in launching cultural projects and influencing the distribution of public funding.

It is important for creators to collect as many votes as possible. The larger the group of members or supporters they attract, the more money they get from the public budget (**Social Network**). However there are limit on donations. The direct donations received from a non-member will not be matched with the public budget to prevent donors from purchasing public funds.

There are different kinds of membership. Those interested in uploading their own cultural projects can join Crowdculture, paying SEK 50 a month for three months at a time. Others can support cultural projects under the same conditions (SEK 50 a month for three months). Others can enter as financiers and start a fund from which cultural creators can seek support.

Locality/localism is also distinctive of Crowdculture. Localism implies being in contact with a nearby concrete reality, in which people have high physical and emotional engagement to particular contexts. This allows citizens to value principles of cultural attainment and proximity. For Crowdculture's manager, involving the audience in a local project enforces **transparency** and promotes **efficient distribution of public funds**.

In fact, the departure point for creating Crowdculture was the EU principle of "subsidiarity". If decisions can be taken at a local level, then they should be. The idea was to transform this concept into a means of allowing local communities to become **directly** and **democratically** involved in the production and financing of cultural initiatives.

5.4.2. Success factors

Quality of projects

Crowdculture promotes dialogue among users to encourage learning communities although there are not very many specific services. The **Crowdculture White Label** promotes contacts to strengthen the dialogue with users and sets the conditions for co-investments.

Crowdculture has a pedagogical programme, funded with public funds, which helps with the project pitch. This consists of a public seminar series and weekend workshops where people can present ideas and get useful advice.

Users participation

²² • Region Blekinge
• Regional Council of Southern Småland
• Sörmland County Council
• Region Dalarna
• Filmregion Stockholm-Mälardalen, Filmbasen
• Region Gävleborg - General culture fund
• Region Gävleborg - Unga cash

In Crowdculture, user participation is understood as a pre-condition for **democratisation**. Ensuring greater efficiency is more linked to achieving greater participation than greater knowledge exchange. Efficiency is hence more attached to democratic practices than to sharing knowledge and experience.

The platform's strategy is to increase its social networks to deepen the democratic components of cultural funding, gain in efficiency and by extension, be more successful.

What Crowdculture defines as "Counter financing", namely the relationship between members' voices and public cultural budgets, depends on how strongly members support cultural projects. The activation of creators' **social networks** is hence vital for success in two ways: they finance the most popular projects and increase the number of users.

Investment thresholds

This threshold is used by Crowdculture as a tool to regulate participation and is highly conditioned by the preference for democratisation. Though there is no maximum limit on the donations, as little as €5 will be taken into equal consideration as a public investment. Even if someone wishes to donate more money, €5 is what will be taken into account in order to achieve a "flatter" membership structure.

This reinforces the democratic character of Crowdculture by allowing all citizens to have the same weight in the funding and decision-making process.

Personalised assistance

Crowdculture provides personalised assistance to those interested in:

- Cutting the costs of pitching for projects,
- Working with users / citizens as co-investors,
- Exposing projects on multiple platforms.

Cost reduction

Cost reduction is taken seriously in Crowdculture, which charges no fees - all the money invested goes directly to the projects. The platform has developed two main patterns of support, namely: through direct donations or through monthly contributions from supporters of SEK 50 (€5.75) a month for at least three months at a time. If a project does not reach 100% of its budget, the money will be refunded to the members' accounts.

Knowledge of Crowdculture's users

Crowdculture currently has about 3,000 members, mostly academically-educated, experienced online users. Only 15% of users do not use social media. They are between 18 and 79 years of age. The average age is 42 years; 70% of users work in the cultural sector; and 12% work in media and communication. In relation to motivation, 75% of funders invest because they believe the proposed project a good idea and only 3% consider profit important.

Follow up

Where public money is concerned, there is an obligation to report back the result of a project financed through the site.

6.4.3. Regulation

Crowdculture has not had problems with **fraud** so far. **Democratic practices and localism** are thought to prevent fraud. The institutions and people Crowdculture works with are known personally and the sums are too small to be of interest for defrauders. Yet Crowdculture's manager admits that **the risk of fraud exists**.

In the Crowdculture manager's view, **tax harmonisation in the EU** would be positive because it would level the playing field among creators, investors and public administrations, taking away competitive tax advantages from the market. Money sourced in Sweden for products to be produced and sold in Sweden will stay in Sweden. Additionally **harmonisation promotes cross-border transparency and makes money laundering more difficult**.

Regarding local taxes, Crowdfunding manager thinks that it is advisable to give tax incentives to people who contribute. This promotes the increase of the money flow through the system and would help the model to become sustainable.

He sees language as the biggest challenge to the financial viability of the system (a small language – e.g. Swedish – makes it hard to get network effects going).

Crowdculture as a Swedish platform is protected under Sweden's **legal framework**, (customer protection and data storage laws). This legal framework is so general that the platform's activities (selling products and services) already fall under it.

Public money from a local tax collecting society must be **reinvested into that society** (according to Swedish regional law). This general framework could be applied throughout most EU countries, without additional legislation.

As a rule, Crowdculture is in favour of **harmonisation, but under the EU principal of subsidiarity**, meaning that what can be done at local level, should be done. Globalisation does not mean the end of local communities: on the contrary, local aspects should be involved in cultural production because proximity also matters in the logic of global connectivity.

Crowdculture's manager is in favour of **harmonising rules for start-ups** as well.

6.4.4. Relations with public institutions

This company **collaborates with municipalities in creating funds** for crowdfunded initiatives in the cultural area. It facilitates a **democratic selection process** for the allocation of a percentage of the public budget to a fund accessible to crowdfunding initiatives operating in the region. The risk that a large investor takes control over decision-making processes is low because membership is open to individuals who provide €5 fees.

It is important to have **political backing from local authorities when setting up a fund** (1-3% of local cultural budget). It is also important to note that municipalities can provide not only funds and grants, but also public spaces and infrastructures. Cities and municipalities frequently run theatres, cinemas or opera houses. Therefore municipalities can help to promote culture not only by providing public funds, but also by allowing creators to use public infrastructure.

Crowdculture likes cooperating with governments, because **negotiation with one actor simplifies many things** (e.g. a fixed fee for the service is agreed on beforehand and paid annually).

As the crowd is still not familiar with crowdfunding practices, fraud is easier. Therefore an EU **action plan to help people to understand** crowdfunding would be a very effective EU initiative.

6.4.5. Future challenges

The challenge for this company is to consolidate its cooperation pattern with the public administration and to explore the viability of crowdfunding practices in other policy domains. The aim of this platform can be seen as binding the administration to the financing of existing cultural activities supported by "the crowd". Although Crowdculture has established efficient mechanisms to

avoid the political control that public administrations could exercise over cultural activities, the risk of control exists nonetheless.

6.4.6. Transferability and scalability

Many aspects of Crowdculture could be of great help to other platforms, especially its experience in bringing together ideas, funds and public (local) administrations.

As Crowdculture's administration does not decide unilaterally on spending, but supports those projects that attract most support from "the crowd", multiplier effects regarding economic efficiency and democratic practices emerge, with subsequent positive effects on participation, growth and employment. This could be applied to almost all public policy domains.

Table 6: Summary of findings in relation to the literature

	User Factors (Motivations)	Success Factors	Regulation	Public Institutions	
Crowdculture	Objectives	<ul style="list-style-type: none">- Connecting social capital with economic capital for culture projects	<ul style="list-style-type: none">- Raise cultural projects democratically	<ul style="list-style-type: none">- Prevent fraud- Harmonised tax and legislation under subsidiarity- Democratic allocation of funds	<ul style="list-style-type: none">- Collaborates with municipalities to allocate funds for culture
	Factors	<ul style="list-style-type: none">- Democratic practices- Networking- Localism	<ul style="list-style-type: none">- Quality of projects- Social Networks- Personalised assistance- Knowledge of users- Localism	<ul style="list-style-type: none">- Fraud no issue- Reinvestment of funds in society- Transparency	<ul style="list-style-type: none">- Negotiation with PA simplifies things- Democratic allocation funds- Democratic policy practices

6.5 LeihDeinerStadtGeld

Name	<i>LeihDeinerStadtGeld</i>
Website	https://www.leihdeinerstadtgeld.de/
Region	Germany
Start-up date	2011
Date of data collection	May 2013
Names of people interviewed	Steffen Boller
Platform figures	One fully-funded project up to date (€83,000 to acquire digital radio equipment for the voluntary fire department of Oestrich-Winkel)

6.5.1. User factors (motivations)

LeihDeinerStadtGeld has been online since 2011. It aims to provide public credit. Financing municipal activities is often difficult because services and infrastructures must be put in place as soon as possible and must be financed from reserves or credits. The current financial crisis is rendering credit access a difficult task that increases citizens' distrust of public institutions and traditional banking credits.

LeihDeinerStadtGeld's main objective is to *advise municipalities and municipal companies on*

community-based funding models. This platform provides a legal and administrative framework and crowdfunding principles (“many giving little”, “for each investor a profit or reward” “engagement and loyalty with projects”) for community-funding practices. Another key idea is to free municipalities from having to depend on bank loans, by drawing resources from citizen credits instead.

Democratic practices. The municipality receives a limited-time loan with lower interest rates to implement those municipal policies that have been agreed with lenders. Citizens can know where their money is and the output of their investment at all times. It allows municipalities and cities to finance themselves through investments directly from their citizens.

All payments go directly to an **escrow account**. The municipality may dispose of the loan amount only after the payment deadline. The platform takes care of the entire administration and settlement of financing via citizen loans without the burden of additional administrative tasks.

Municipalities that want to finance a project through a *civil credit* must meet legal and regulatory requirements in advance. These include the **legitimacy** of political leadership and the integration of **citizens' credit in the municipal budget**. The inclusion of citizens' loans improves democratic services and transparency. Registering on the local LeihDeinerStadtGeld ensures all requirements are met in full.

With **civil credits**, democracy is reinforced, as the city represents the citizens through the use of the public credit as well. This promotes transparency, trust and ultimately the bond between city and citizens. For the first time, citizens can strengthen participation in the city budget, not only through taxes but also through civil credits. The municipality may borrow money in the future from its citizens, so as to implement their projects.

They have a second platform on the same site that unites **renewable energy** initiatives with potential investors.

6.5.2. Success factors

Quality of projects

Usually the municipality launches a project and provides the required funding, so that the quality of projects depends entirely on them. LDSG's staff provides hints of how to present the projects and other issues to attract lenders. Investors make small financial contributions to the total required capital. In return, the investor receives a payment in kind or in cash.

We have seen how other analysed platforms help creators to improve their projects and campaigns. LeihDeinerStadtGeld provides a very similar service, but exclusively to local institutions, mainly City Councils. The lending-based character of this platform explains this specialisation.

User participation

Given LeihDeinerStadtGeld's strong commitment to enhancing the democratic quality of municipal financing and involving citizens in the development of municipal utilities services, it seems clear that one of the most important tasks is to increase participation as much as possible.

Participation is here understood as the capacity to attract both City Councils and citizens in order to redefine patterns of finance at local level. The greater the number of institutions and citizens who participate in this new channel of democratic financing, the greater the number of projects which can be implemented.

In order to allow more and more citizens to participate as lenders to their own City Hall, this platform sets very low investment limits. There is a loan maximum threshold to promote massive participation, although there are also mechanisms which allow citizens to loan larger amounts if

they are able and willing to do so. These citizens can split their loans into smaller amounts. So that all citizens are able to provide a loan, the minimum is set at only €100. Larger amounts must be divisible by 50 (e.g., €150, €300 or €4,500). The credit quota defines the maximum amount: it is not possible to lend a community more than the amount requested by the City Hall.

Providing a socially valuable financial product that promotes transparency and understanding of municipal financing mechanisms is a business opportunity for citizens, which offers extremely safe investment with a fair market interest rate.

Moreover, the advantages for the municipality are obvious. It receives a limited-time loan at attractive low interest rates, always below the interest provided by commercial banks. Politically speaking, municipalities get very useful inputs to decision-making processes and additional legitimacy to run institutions. City Halls are by-passing traditional commercial banking services, which benefits the interests of the whole population and the democratic quality of municipal policies.

Crowdfunding puts the pitched project together with the target group and provides an indication of the sustainability of the project. Even the project outline can be refined through a crowdsourced process as many platforms allow or even encourage people to contribute their talent or ideas to the project. Starting a crowdfunding project means starting a communication process. Establishing communication around a project is the kick-off point for the dissemination of project results at a later stage

Services and personal assistance

The platform provides a legally-approved model for business. This makes it pretty straight forward for investors. It also carries out marketing services. Projects are local and the city takes care of marketing through free space in the local media, but is assisted by LeihDeinerStadtGeld (mailing, public conference etc.). The platform is committed to ensuring that the loans to municipalities meet the requirements and supported projects come to fruition.

This is the best example of services for the launched projects being essential in LeihDeinerStadtGeld. It expresses the real commitment of these platforms to users, citizens and municipalities.

Cost reduction

The logic regarding cost reduction is significantly different in Leihdeinerstadtgeld because the creators and “entrepreneurs” are municipalities. This does not mean that reduction in costs of accessing credits is not considered on this platform. On the contrary, the very existence of this platform is an attempt to reduce funding costs for local public institutions right from the start.

The Manager agrees with those users and experts who claim that crowdfunding is a low cost way of accessing capital, although in the case of Leihdeinerstadtgeld the recipients of these low cost funds are local administrations instead of anonymous creators and entrepreneurs. Municipalities benefit from cheap funds to finance municipal projects without resorting to traditional banks. Citizens and other lenders benefit from attractive interest rates and the possibility to use the implemented projects (kinder gardens, parks, a new fire station). It is clearly a win-win solution where both parties benefits

Knowledge of Leihdeinerstadtgeld’s users

Users are private individuals from all walks of life aged 30 years upwards, and cities and municipalities. The reasons why private individuals invest in municipal projects vary from affinity with the project to a desire for profit, although the “sense of belonging” is repeatedly reported as one of the main reasons for lending. Obviously interest rates also matter, but they tend to be

secondary because they are always lower than those from traditional banks.

6.5.3. Regulation

As in the case of the rest of analysed platforms, there have been no problems with fraud so far in LeihDeinerStadtGeld. The particular nature of this platform provides interesting anti-fraud incentives and practices.

Projects and campaigns seek to affect the economic activity and public services of local entities and municipalities. ***Social control is a very important way of preventing fraud.*** Defrauding your neighbours or municipality is viewed as much more critically and punitively than defrauding anonymous people and institutions in the web.

For these reasons, this platform considers that ***specialisation in funding local projects in municipalities is more attractive and efficient than no geographical specialisation (Locality/Localism).*** Economically speaking, the world as such is still too big and cross-border transparency is more difficult to guarantee.

In general, and depending on the crowdfunding activity, it is not always easy to work within the existing legislation. Taxation is a country specific activity and there are many exceptions and particularities. Capital gains tax is owed.

The manager of LeihDeinerStadtGeld suggests that ***tax advantages for crowdfunding start-ups*** within country borders could be useful. The crowdfunding economy is not consolidated yet, which presents higher risks in trust, investment and sustainability. Therefore ***public support for crowdfunding services*** would be the most efficient way for governments to promote crowdfunding.

It took the platform, working with the German financial regulatory body, 1.5 years to come up with the legal framework for the platform to operate on. Loans regulation in Germany did not initially allow citizens to crowdfund municipality loans to implement specific programmes.

Far from being an intractable problem, the very lack of legislation on this subject prompted the birth of this platform. *Leihdeinerstadtgeld* was founded as an attempt to solve the problem of the lack of legislation on private loans to municipalities.

The manager of *Leihdeinerstadtgeld* sees no current need for harmonisation at European level. The Manager thinks it would be difficult to harmonise legislation as crowdfunding practices are quite diverse. He does not deny the validity and promising prospect of a harmonised European legislation for crowdfunding. He simply warns of the risks of a single legislation for a very diverse sector.

6.5.4. Relations with public institutions

Leihdeinerstadtgeld is a fine example of the crowdfunding-institutions relationship. Although it was not possible for citizens to finance municipal loans, as there was no legal and administrative framework to work with in Germany, a municipality decided to crowdfund a loan from its citizens anyway, with great success (€4 million in three days). This was later deemed illegal by the German Financial Regulatory Board, as it infringed banking loans regulations.

However, *Leihdeinerstadtgeld* saw this experience as a positive basis for similar initiatives in other municipalities and created a legal environment that did not upset existing regulation. *Leihdeinerstadtgeld* provided the administrative and legal outlet needed by a collective initiative – i.e. a crowd-driven platform highly specialised in bringing together institutions and citizens.

In *Leihdeinerstadtgeld's* view, the main aim of public institutions should be to simplify the law and provide customer protection regulation that is specific to crowdfunding. At the same time, it is a business opportunity for citizens to provide a socially valuable financial product that promotes transparency and understanding of municipal financing among citizens, while offering an extremely safe investment at a fair market interest rate.

6.5.5. Future challenges

The consolidation of this lending practice involving citizens and public administrations is perhaps the most important challenge facing this company. The success of this company lies in being able to establish novel guidelines to financing public administrations under democratic principles. However, this experience has faced serious legal problems with institutional bodies at regional and state levels, which are wary of the consequences of this experience on traditional banking services and on the monopolistic control that public administrations exercise on policy strategies. The fact that this platform took more than one year to set up a legislative framework is a good example of how difficult it is to consolidate lending practices when operating with public administrations.

6.5.6. Transferability and scalability

The benefits associated with this new crowdfunding practice are of paramount importance. Thanks to the loans that citizens make to their administrations, new windows of opportunity are being opened for more efficient lending regimes and more democratic public expenditure practices.

Table 7: Summary of findings in relation to the literature

		User Factors (Motivations)	Success Factors	Regulation	Public Institutions
Leihdeinerstadtgeld	Objective	- Lending to municipalities	- Enhance democratic municipal financing	- Prevent fraud - Solve lack of legislation on private loans to municipalities. - Democratic allocation of funds	- Avoid municipalities to depend on banking loans. - Civil credits
	Factors	- Escrow account - Run settlement of financing via citizen loans - Integration of citizen's credit in the municipal budget	- Quality of projects - Social Networks - Personalised assistance - Knowledge of users - Localism	- Localism - Geographical specialisation - Tax reduction for start-up - Simplify legislation - Public support for CF services	

7. Final Analysis and Report

7.1 Summary of the field analysis of case studies

The analysis of case studies confirms most of the findings in the literature regarding motivations, success factors, regulation and relation with public institutions. However confirmation of existing knowledge is not the most relevant contribution of this report. It provides new evidence that confirms the distinctiveness of crowdfunding as a new financial system with its own logic and purposes.

Table 8 below links the case findings to issues raised in the literature with regards to user factors, success factors, regulation and the role of public institutions. These aspects are further developed in the next sections of this Chapter.

Table 8: Summary of user and success factors in crowdfunding

User Factors		Success Factors
Alternative Economy	Profitable Economy	Components
CF challenges the ethical code of those projects that exclusively focus on maximising investment.	CF reduces the transaction cost, making financing cheaper .	Users' capacity to activate Social Networks , (the number of family members, friends and contacts in social webs)
Fairness, transparency and cooperation matter .	CF enables bypassing the intermediaries of a traditional supply chain.	Projects' cultural attachment with underlying cultural products of the geographical area (liking for local)
Backers and donors value being part of a venture they can identify with	CF reduces the associated risks of investment	The nature of the population in which funders operate
Creators retain full control of the idea and they can test the popularity of a project	CF allow creators to access funders with an inherent interest in a more personalised product	The quality of projects and campaigns
Philanthropic platforms tend to be more successful because they are more flexible in maintaining a quality-quantity mix	Cheaper process of engagement with geographically dispersed funders and donors	Target Budget . Beginning with a modest goal and having a compelling project can reap great success
Users' engagement in the whole productive process is vital to gain in efficiency and democracy.	CF enables linkage of the pitched project with the target group and provides an indication of the sustainability of the project .	Target Budget . Projects generally are successful in fundraising by small margins . Failures happen by large amounts, successes by small amounts
Managers often receive very useful advice and even tangible offers of assistance from backers	Donations are only the strongest motivation for 22% of entrepreneurs .	Target Budget. Past cumulative investment positively affects the chance that new investment obtained
Although philanthropic projects are still predominant, equity for profits is growing faster.		Controversy : financing is more difficult for small target budget platforms because the lack of available historical data creates information asymmetries that dissuade potential investors from funding these campaigns
		Involvement and Engagement are key because the "wisdom of the crowd" is a powerful instrument of improving crowdfunding efficiency

Regulation			Public Institutions
Fraud	Taxation	Legislation	
Lack of accountability. Platforms act as intermediaries. Responsibility in fraud diminishes	Taxation is complex because there are multiple types of platforms and users.	Lack of Legislation. No European legislation on crowdfunding	The role of public institutions in promoting crowdfunding is very limited
Lack of information. The pool of funders has no personal contact and/or real knowledge of the business plan	While creator is often one individual, the project benefits a variety of entities with different tax status	Two-tier legislation. CF platforms have to comply with EU, national and local legislation on taxation.	Institutions creates new legitimacy for using crowdfunding services
Lack of credentials. No credentials are needed to post or fund a project	Rewards are often a mixture of investment, donations, and goods	Copyright Protection. Creators are exposing ideas to others who could copy them.	They provide an additional input to decision-making by supporting those projects that have been successfully crowdfunded
Controversy. Fraud is believed in: "Fraud Bogeyman"	Social security issues are not well defined in crowdfunding	Accountability. Once the project is posted there are few legal obligations to deliver on promises.	Crowdfunding innovate traditional public funding regime , setting up bottom-up funding initiatives
Platforms can prevent fraud. Creators can decide on the type of funders they want?	Tax reduction encourages crowdfunding expansion	Current legislation does not promote efficiency and transparency because it is designed for incumbent investment setting	Crowdfunding enables linkage of the pitched project with the target group and provides an indication for the sustainability of the project
Although fraud is easy in theory, it is still rare in practices. Delays in delivery of project promises are the real issue			

Managers have embraced this new logic independently of the platform model they run. The way they understand *success* and the strategic options to increase the success rates are the best expression of this new crowdfunding logic. From the perspective of this report, what makes crowdfunding a truly new funding system is the determination of managers to improve their efficiency without sacrificing transparency and democratic practices. Efficiency and democracy are not presented as antagonistic but as complementary elements which increase the number of successful projects, the best indicators of success.

This logic also affects our conceptions of production and consumption in the crowdfunding space. Crowdfunding seems to progressively alter the binary notion of consumer-producer, typical of "traditional" industries, toward more complex patterns of relationship. Consumers are not exclusively the target of production in crowdfunding, but the instigators thereof. They are directly linked to production not only through consumption, but also through finance and creation, effectively integrating these actions into the crowdfunding market.

The analysis of case studies enables the identification of specific strategic options to gain efficiency (success factors) and the economic consequences of democratic practices. The report also provides relevant findings in other areas of crowdfunding management related to regulation and relations with public institutions.

Managers do not perceive fraud as a critical challenge, they consider that the harmonisation of legislation and taxation at a European level would positively affect the consolidation and expansion of crowdfunding, and they encourage public institutions to invest in crowdfunding projects to help platforms grow and as a means of allocating public funds more democratically. Managers encourage not participation as such, but rather the “right participation”, which means attracting users who share similar values and purposes.

It follows from all this evidence that the main challenge for managers is to create a new and efficient dynamic between the institutionalised side of the market (rules and regulation) and the requirements of democratic practices needed to optimise efficiency in crowdfunding services. In what follows, I will present the main contributions of this report in much more detail.

7.2 User factors (motivations)

The literature on user motivations seems to move between two paradigms. On the one hand, it announces the arrival of a new economic paradigm linked to the incumbents of the new Information Society (“non-market production”). On the other, it suggests that the “new” economy is just a way of doing business by other more technically-sophisticated means (“profits by other means”).

It is a dilemma that influences the strategic options of each platform. Equity and lending-based platforms would be the response of the crowdfunding industry to satisfy the demands of those users who primarily seek profits, whereas reward and donation-based platforms would be the space for those more willing to operate under non-market rules. Our analysis confirms that the type of **crowdfunding model** matters in explaining differences in the factors affecting managers’ motivations (**User Factors**) for running a platform. We see that each platform has put into motion a distinctive strategy to meet their mission statements.

The management of Symbid faces the challenge of ensuring profits and “ownership for all” by ensuring a safe environment for businesses and improving the efficiency of its success factors. The 1%Club meets its goal to increase donations and awareness by promoting sustainable projects, reinforcing its ethical code and by making people's time and knowledge exchangeable products. Verkami's priority to ensure that innovative projects receive funding is based upon a strict selection process that admits only the most creative and innovative projects, reinforces safe business environments and promotes trust and cooperation. Crowdculture achieves the goal of connecting social capital with economic capital for cultural projects by reinforcing democratic practices, networking and localism, whereas Leihdeinerstadtgeld faces the challenge of lending to municipalities by encouraging citizen loans and integrating citizens' credit into the municipal budget.

In spite of these divergences, this report also concludes that the decision-making process at managerial levels is highly conditioned by the **economic efficiency–democratic practices** mix, independently of the particular crowdfunding model. This new management style, here labelled as “**efficiencracy**”, is distinctive of crowdfunding, namely the idea that efficiency cannot be promoted at the expense of democratic practices, since both are seen as necessary and complementary conditions of success.

Whatever the strategic objectives of each platform, all managers are aware that they must avoid efficiency-democracy trade-offs that threaten the sustainability of their companies. The real measures of efficiency in crowdfunding are the projects that it makes possible. Regardless of their type (equity-lending-reward-donation), successful projects mean the platform grows organically, attracting more participants and increasing the number of projects launched.

The object of efficiency is hence to create an attractive economic environment which reduces investment risks and the resistance to the newness embedded in crowdfunding. As intermediaries

between projects and capital, the managers are the key to allowing the best projects, assisting creators and funders, facilitating transactions and verifying customer rights.

The object of *democratic practices* is to create a trustworthy environment for encouraging bottom-up initiatives under more transparent rules and practices. Managers become crowd-driven instigators of new forms of coordination which optimise the relationship between supply and demand forces in a more democratic way. This role is vital in expanding crowdfunding services.

Managers also hold the view that **transparency and efficiency** are highly related in crowdfunding services. The more transparent the system is, the more efficiently crowdfunding practices work. There are reasons for this view. Transparency is thought to optimise efficiency by allowing all parties involved to function without friction. It allows users to evaluate exactly the potential of their projects and investment, see where their money is allocated, who will manage it, how much the project is going to cost and how long it will take to finish. This reduces uncertainties and the risks associated with start-up, while favouring a better understanding of crowdfunding practices.

Managers have also reported the importance of **involvement and commitment** in improving efficiency and reinforcing the sustainability of their crowdfunding companies, in line with findings in the literature. Increasing participation is a common objective for managers. Yet, attracting users is not about increasing participation as such, but about increasing the “**right participation**”. There is a **Restrictive Acceptance Level** based on affinity with the site’s values and functioning systems, so that the higher a company’s empathy value, the more restrictive the acceptance is. All managers have their own criteria for allowing participation, but they emphasise the importance of participant selection based upon affinity. The purpose of this restrictive filter is to gather those users who are most sympathetic with the platform’s goals and purposes.

The five platforms examined promote affinity with the principles of the company by filtering according to the type of projects and investment accepted. Filters such as selection process, reviewing projects, feedback and technical assistance, thresholds on investment and donations to guarantee that ideas remain in creators’ hands, allow managers to increase “the right” participation for their companies.

7.3 Success factors

This report concurs with the literature as regards success factors. The managers interviewed also agreed on the most effective strategies needed to improve effectiveness and success rates. All the managers interviewed said they focused on the following success factors:

1. improving the quality of the projects and campaigns,
2. encouraging growing user participation,
3. providing personalized assistance,
4. reducing financing costs and
5. having a clear understanding of their users’ needs.

The literature on this issue recognises the importance of innovation in the sustainability of crowdfunding companies. Indeed, the birth of crowdfunding is an innovative response to the problems of finance and lack of access to credit by innovative projects in cultural sectors. This report confirms the importance that managers attach to innovation.

They agree that crowdfunding should be a **low cost way of accessing capital**, which is expected to increase the number of users accessing crowdfunding services. This quantitative expansion is complemented with incentives which involve funders and donors in the whole productive process to improve efficiency.

Most literature on success factors agrees that internationalisation is a necessary step in the expansion of crowdfunding companies. Yet, this report provides for-localism arguments as well. Some platforms are tied to local development and do not have many incentives for internationalisation, for example, Crowdculture and Leihdeinerstadtgeld. On the contrary, they make a virtue of localism as a strategic option which enables them to enjoy the advantages associated with proximity.

7.4 Regulation

Managers do not perceive **fraud** as a critical challenge. It is a potential risk that challenges the quality of services and the efficiency of their business strategies, but not a real handicap. Managers are aware of the positive effects of good practices in realistically reducing the risk of fraud. Most of their strategic programmes employ principles of transparency, trust and cooperation to prevent fraud in line with “anti-fraud bogeyman approaches”.

7.5 Legislation

Managers hold the view that the **harmonisation of legislation and taxation at European level** would positively affect the expansion of crowdfunding as it would:

- i. create a sustainable ecosystem for funding entrepreneurship.
- ii. simplify the law and reduce bureaucracy.
- iii. take away arbitrary opportunities to defraud the system.
- iv. level the playing field among creators, investors and public administrations, eliminating inequalities in the domestic market.
- v. improve incentives and tax advantages for crowdfunding in the EU space.
- vi. promote cross border transparency and make money laundering more difficult.
- vii. clarify the situation for all concerned parties (creators, entrepreneurs, investors, donors and public institutions).

Yet, there are important differences among managers' views and practices regarding the potential of harmonisation. Although tax and legislative **harmonisation** enjoy the support of most of the managers, harmonisation is also viewed with suspicion because:

- it would require the development of a common European framework which would probably be slower to establish than national frameworks: it would therefore slow the growth and impact of crowdfunding in countries that wish, and are able, to move faster.
- Harmonisation frequently means *commodification* (mercantilisation) of most policy domains in the current process of EU integration. Although it is still too early to foresee the effect of commodification on the crowdfunding industry, the risk of concentration of platforms acting as **oligopolies** should be considered for prevention.
- Harmonisation means **standardisation**, which is not a value often mentioned by the interviewed managers. Indeed, harmonisation may not be fruitful since crowdfunding services are quite diverse. Excessive harmonisation could hamper the diverse expansion and experimentation required by the crowdfunding industry.

Internationalisation/localism. Divergences have been also observed in how to interpret and develop a strategic plan for expansion. Although internationalisation is not questioned, incentives for internationalisation are different and some platforms prefer the advantages of proximity. Three out of the five analysed platforms consider that internationalization of their company, and of the crowdfunding industry as a whole, is a necessary strategy to ensure the sustainability of their business models. Internationalisation means the adaption of all platform tools and logics to the requirements of a global network. Projects need to be adapted to the diverse cultural contexts of the new networking society (many languages will operate in the platforms although English will

tend to be predominant, potential investors will belong to different cultures/cultural contexts which will interpret the contents and purposes of the launched projects, different taxation and legislation regimes).

New technologies allow users to exchange information in real time on a global scale at very low cost. This is certainly an incentive for internationalization. Anyone with Internet access can enjoy the benefits associated with the practice of crowdfunding (low cost ways of finance, learning community, transparency, good opportunities for investment), which is certainly an incentive for managers to encourage internationalisation.

Yet, some platform models are much more interested in experimenting with the elements closest to their everyday economic realities. They offer neighbourhood, or municipal projects, which are developed in the community and funded by small contributions. There may be agreements with local authorities to jointly fund these citizen initiatives.

Localism is interpreted and used in a flexible way to extract the benefits of proximity and trust in various areas of management action. Localism for both Crowdculture and Leihdeinerstdtgeld means proximity. However, localism for Crowdculture is also about connecting social and economic capital, whereas for Leihdeinerstdtgeld, it is to reduce the risk of fraud and promoting “civil credits”.

7.6 Role of public institutions

The role that **public institutions** may play in the crowdfunding economy has also generated some consensus. Most of the interviewed managers advocated public investment for those projects which attract more support on their platforms. This idea of turning administrations into investors and donors has positive economic and policy connotations: above all it would bring in additional resources for platform to grow and provide a more democratic means of allocating public funds.

Some managers have reported the need to preserve the **principle of subsidiarity** inherent in EU functioning. Decisions taken at international level could render local policy action meaningless, reducing the positive effect that proximity generates on confidence, and by extension on the development of crowdfunding. This report provides good examples of collaboration between platforms and local institutions for economic efficiency and democratic gains.

8. Opportunities, Challenges and Policy Options

In its “*Consultation Document: Crowdfunding in the EU - Exploring the added-value of potential EU action*”²³ the European Commission invites European citizens, stakeholders, etc. to express their views on how European action could help unleash the full potential of crowdfunding in the EU through a series of questions:

- Given that crowdfunding is expanding, is there a problem that justifies specific policy intervention, including EU level action?
- Could a large-scale scandal undermine the confidence of contributors in this early stage of the industry's developments?
- Is there added value in EU-wide market access and is there a real demand for EU-wide crowdfunding campaigns?
- Are there legal barriers that impede cross-border access or render it overly burdensome for certain forms of crowdfunding, such as financial forms?
- Is there a need to treat crowdfunding with a social impact differently from other forms of for-profit campaigns?

This report has identified a number of opportunities and challenges linked to the expansion of crowdfunding with relevant implications for policy action. The most significant opportunities, described in the following section, are crucial in understanding the sustainability of the crowdfunding industry and the potential of crowdfunding in creating growth and employment.

8.1 Opportunities in the use of crowdfunding

Crowdfunding is an active mechanism for capital formation that supports entrepreneurship and business creation:

- 1- By reducing the financial costs. Crowdfunding is a low-cost way of financing, because it bypasses the intermediaries of a traditional finance chain, which reduces financial cost and increases the interest of entrepreneurs, investors and donors in supporting crowdfunding projects.
- 2- By reducing the both the risks of setting up a firm and of investments. Very frequently, projects presented on crowdfunding platforms are low-budget, and often financed by a large audience, where each individual provides small amounts of money. This preference for small target budgets reduces risks and encourages investment.
- 3- By providing tailored financing methods that fit well with the financing needs of start-ups. Small target budgets and the establishment of certain investment thresholds allow a wide range of investment and investors. For as little as €10, a person can become an investor, which would certainly encourage more people to invest or donate. At the same time, maximum investment thresholds are also very frequently established to impede the appropriation of ideas.
- 4- By addressing lack of finance in certain sectors of activity. Indeed, crowdfunding establishes new revenues for new industries. Although there are many examples, crowdfunding campaigns to raise awareness of scientific projects, minority sports and political campaigns are the most representative cases of these new sectors recently covered by crowdfunding.
- 5- By amplifying the scope of projects and the number of users. Thanks to Internet, the potential audience to support crowdfunding projects achieve a global scale is huge. Everyone who has a credit card can support a project, which allows efficient processes of engagement with geographically dispersed funders and donors.

²³ European Commission. Directorate General Internal Market and Services. Financial Markets/ Securities market . Brussels 03, October, 2013.

http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/docs/consultation-document_en.pdf

- 6- By acting as mediator between ideas and investment over a short period of time. This is important to support entrepreneurship and creation because it allows entrepreneurs to test the acceptance of their products and services in a reasonably short period of time.
- 7- By ensuring creators and entrepreneurs retain full control of their ideas and how they are implemented. Once a project has achieved its target fund entrepreneurs preserve their autonomy to carry out their project. There is no negative interference from investors; on the contrary, entrepreneurs can benefit from them by testing the popularity of their projects, getting very useful feedback, activating their social-networks, etc. This is also a way of finding support.

Crowdfunding offers the opportunity of building up support from potential customers, stakeholders and target groups. This results in richer interactions, often based on learning exchanges, which help creators to gain in innovation, creative adaptation, wider diffusion and higher perception of their product newness.

- 1- Crowdfunding is not just about getting funds or donations, but also about attracting the emotional interest of potential investors and donors, who explicitly declare their desire to participate in the process of product creation, improvement and diffusion as part of their compromise with the project.
- 2- Investors in crowdfunding tend not to look at collaterals or business plans, but at the ideas and core values of the firm. They show an inherent interest in a more personalised product, which explains their propensity to finance on more favourable terms.
- 3- Crowdfunding exploits the capabilities of *social networks and other new features of Web 2.0*, especially the function of “viral networking and marketing”.
- 4- Crowdfunding also exploits the advantages associated with community and proximity (learning communities, exchange of ideas, market testing, *pre-sales, word-of-mouth*), which improve the quality of the presented projects and their viability.

Crowdfunding promotes employment and new ways of labour inclusion. This is perhaps one of the least known effects of crowdfunding, which requires additional research and investigation. The little evidence we have suggests that:

- 1- Self-employment is distinctive of crowd-jobs. Many of the funded projects observed in this study belong to a single creator or entrepreneur who finances their own personal project (writing a book, filming a documentary etc.). The fact that the services and cultural sectors still dominate in crowdfunding (see Section 4.2.1), may partially explain this tendency in the type of jobs created by crowdfunding. Since a large number of crowdfunding projects stem from the cultural sector (films, music, games, comics and literature), self-employment and small firms tend to be the natural solution, and by extension, a fruitful way to promote this type of employment, especially during times of economic crisis, as is the case today.
- 2- Yet, the expansion of crowdfunding toward other sectors of activity, mainly industrial and agricultural sectors, may change these patterns of employment in times to come. We found evidence on platforms promoting high target budget projects (SociosInversores is a good example) that many projects in these sectors require wage-workers in a more traditional way.
- 3- Although evidence for the number of dependent or wage-earning employees created by crowdfunding is scarce, we know they tend to be of a temporary nature, and linked to the realisation of a certain economic activity. Whether it is to fund a concert, a DVD or a movie, the job ends when the funded activity ends.
- 4- Youth is also distinctive of crowdfunding according to the information provided in this report. The profile of users (30-40 years old) suggests that crowdfunding users tend to be younger than users of traditional banking services. This may indicate that crowdfunding could address and improve the undercapitalisation of young business and investment. This creates news spheres of professional activity and skills updating, which is likely to require active new labour policies specifically focused on young creators, investors and donors.

Crowdfunding is already providing a distinctive way of management. This we can tentatively label as “*efficiencracy*” for crowdfunding managers' willingness to reconcile economic efficiency and democratic practices, very effective for and adaptable to the requirements of the New Information Society.

- 1- This new management strategy, highly idiosyncratic of crowdfunding practices, seems to overcome some major challenges related to the foundation of a new economy in the era of ICTs. The idea that transparency, horizontal participation, learning communities and other democratic practices are not detrimental, but beneficial to economic efficiency is certainly a challenge to prevailing mainstream economic paradigms.
- 2- The expansion of this management practice adds a sense of democratisation and economic patronage, which is particularly promising at this stage of the economic crisis.

Public institutions have not been very active in helping the expansion of crowdfunding so far. Yet there is increasing interest in crowdfunding in two main directions.

- 1- Interest in the wide range of economic possibilities that crowdfunding creates and promotes, from new revenues to finance to a new space for creation and innovation and the economic inputs in terms of growth and employment creation.
- 2- Interest in the potential for novel forms of co-financing and democratic input to funding. Policy action could learn from *efficiencracy* how to benefit from this managerial strategy and how to promote additional inputs to the decision making process, set up more innovative public funding regimes, gain additional legitimacy for public institutions and encourage investment targets based upon criteria of sustainability.

The potential growth of crowdfunding is significant given the growth in the number of platforms, campaigns and investment over the last few years. Although more citizens are becoming aware of crowdfunding, it is either poorly understood or completely unknown to many citizens. This suggests that the possibilities for expansion are enormous if awareness and learning programmes are able to attract the interest of creators, investors and donors.

8.2 Challenges for the development of crowdfunding

The set of opportunities described above justifies the implementation of a coherent plan to stimulate and encourage the expansion of crowdfunding. Yet this report has also identified the following potential risks considered to be obstacles to the expansion of crowdfunding:

- its novelty, continually changing nature and lack of research knowledge,
- Accountability and regulatory uncertainty,
- Lack of awareness of good practice,
- Uncertain sustainability of platforms,
- Public institutions are interested, but they still lack knowledge and a code of good practice.

Novelty, continual change and lack of research knowledge. Crowdfunding is still a rather new economic phenomenon judging by its scope, scale, accumulated experience and level of activity, so the current profiles of users, strategic options, motivations and outputs may not match their equivalents in the future. Crowdfunding is too new for researchers to be able to predict how it will expand and consolidate, even in the near future.

- 1- The expansion of crowdfunding is likely to bring about new technical and economic conditions that will require new motivations and strategic options to survive. In order to foresee this expansion, a profound and detailed knowledge of how these changes take place is of great importance for policy action.
- 2- There is a clear imbalance between the quantity and quality of reliable data on crowdfunding between the USA and the EU. Further efforts could be made to create an updated European database to elaborate annual reports on the state of the art in

crowdfunding in Europe. This database could be complemented with qualitative analyses focused on the users' views on the current state of crowdfunding.

- 3- Lack of awareness of good practice is also typical of the early stages of any process that has just begun. This is a big challenge for the expansion of crowdfunding. The knowledge that the crowdfunding community has accumulated over the last few years to improve the quality of crowdfunding practices is key for the consolidation of crowdfunding. The promotion of good practice codes for consumer protection deserve special attention, as does the study of patterns of investment and donation to avoid certain risks already affecting crowdfunding services (see below point 2 in challenges). This information will be crucial for the design and implementation of policies to help the crowdfunding industry expand.
- 4- Managers interviewed for this report have identified several difficulties in managing platforms. These are associated with the increased management of e-networks; protection of ideas and investment; identification of new productive areas where crowdfunding could easily grow; institutional support for innovative start-ups using crowdfunding for launching projects; and lack of experience in dealing with process of internationalisation.

Potential role for policy

- a. At this stage, **multi-stakeholder awareness-raising programmes** would be beneficial. As this report has observed, citizens are increasingly aware of what crowdfunding is, but still need a better understanding of the potential of this new way of financing ideas and projects. Promotional plans in close collaboration with the crowdfunding industry would seem to be a key step towards encouraging crowdfunding participation. These plans would establish two basic priorities: to show citizens what crowdfunding is and to advise citizens on the opportunities of crowdfunding.
- b. **Learning programmes targeted at entrepreneurs** not currently working with the crowdfunding sector could be also implemented. The idea would be to teach economic sectors, not yet using crowdfunding, of its distinctive added value and benefits. The way in which crowdfunding users build-up networks, design marketing strategies, encourage the creation of learning communities and foster democratic practices, might be of great value for entrepreneurs in traditional industries.

Platforms are intermediary brokers between creators and funders that play a limited role, so their capacity to mediate in conflict is rather fragile. This justifies the need for a specific legislative framework for crowdfunding services

1. Although fraud is widely discussed as a risk, the managers interviewed for this report do not see fraud as a real challenge nowadays. Yet the mere fact that some cases of fraud may arise makes a strategy for prevention necessary. This could consist of awareness and learning programmes and also legislative measures.
2. Project delays seem to be a more serious issue. Crowdfunding implies a time difference that increases the risk of delay in meeting the obligations undertaken by both creators and investors or donors. The crowdfunding industry and public institutions could establish a best practice code that rewards compliance with agreements on time and penalizes delays. This kind of measurement would help crowdfunding to gain in professionalization and trust.
3. Lack of both post-investment communication among stakeholders and follow-up services to check the sustainability of the projects launched also constitute a handicap to the expansion and consolidation of crowdfunding. Public institutions could cooperate in this initiative by participating with platforms in following-up the evolution of the financed projects. The advantages are clear for professionalization and trust, and also for improving knowledge of good practices.
4. Taxation is complex in crowdfunding since there are different types of platforms and users and different tax regimes. The invested income is assessed differently according to whether

the project offers profits or non-material rewards, or if it has been launched by a company or a charity. A hypothetical harmonised legislative framework would have to consider the diversity of platforms to guarantee a wide range of possibilities for entrepreneurs and investors.

5. Social taxation constitutes a very sensible issue. The abundance of different social legislative frameworks in the EU may encourage certain risks of dumping and a “race to the bottom tendency” in crowdfunding.
6. Two-tier legislation is also an obstacle for companies and investors that have to comply with both EU and Member State legislation.

Potential role for policy

- a. This set of risks would justify a harmonised regulatory framework to offer security in transactions, protection of ideas and investment and legislation, prevention of money laundering, etc. This report finds that managers agree on the need to legislate crowdfunding services.
- b. Policy could also implement a “Reduction of risks programme” considering some of the aspect underlined above.
 - A regulatory framework with high degree of simplification of the laws and bureaucratic practices.
 - This regulatory framework could be complemented with a strategy for prevention through awareness raising and learning programmes.
 - Best practices codes in close collaboration with the crowdfunding industry and its representative associations could also be developed.
 - Policies to level the playing field to make the crowdfunding market more accessible, public investment in projects showing strong support and transparency in the allocation of public money.
 - Post-communication and follow-up practices to check the sustainability of the launched projects are also recommended to avoid certain risks and learn from good practice.
 - Additional efforts to set up a tax regime for crowdfunding services at the EU level may clarify and help the expansion of crowdfunding on a European scale.

Uncertain sustainability of platforms

Evidence suggests that crowdfunding has a promising future, but it is still too early to know what its potential growth would be or what the reaction of traditional banks would be, if crowdfunding becomes a real alternative to traditional lending services.

There are some obstacles that suggest the process of crowdfunding expansion is not straightforward. Weaknesses and limitations could emerge, which would hinder the consolidation and expansion of crowdfunding.

- 1- The preference for the small (small target budget, large audience providing small amount of money etc.) suggests that crowdfunding is not ready to finance big target-budget projects yet. This preference for the small is certainly useful to promote participation, but it is also a limitation for expansion. This is likely to be a big challenge that will deserve special attention for crowdfunding managers and users in the future.
 - a. One of the possible consequences of the expansion of crowdfunding is a latent conflict of interests between creators and investors, between small and big investors, between platforms and public institutions and between platforms and public institutions.
- 2- Projects are exposed to a public audience, with the consequent risk of plagiarism and copying. However, not exposing ideas and projects would undermine one of the most significant crowdfunding features, namely transparency. This trade-off between

transparency and opacity is likely to affect the future development and sustainability of crowdfunding.

- 3- It is difficult to know whether crowdfunding will evolve toward oligarchic patterns of competence, where a handful of companies will control most of the market, or whether it will become a more specialized industry where many platforms can survive by responding to the financing needs of a growing number of creators and entrepreneurs.

Potential role for policy

- a. In order to support the sustainability of platforms, policy makers could allocate a budget to finance those projects that have almost, but not quite achieved their target budgets. Institutions would act as a complement, but never as a substitute, to “the crowd”, using the democratic selection process observed in this report as a mechanism to avoid the risk that any one big investor gains control over the decision-making process.
- b. Policy makers could reduce the tax burden for crowdfunding platforms and for start-ups to encourage participation. The consequent reduction of tax revenues could alleviate the lack of a law of patronage for e-firms and crowdfunding services. This could be compensated for by increasing economic activity and employment, which would increase revenues via VAT.
- c. The already accumulated experience of managers and users in crowdfunding should be appreciated, and policy makers should not create new crowdfunding platforms. This would be detrimental to competition and would undermine the sustainability of existing platforms. Instead, the EU should encourage the use of existing ones by creating stimulus for participation.
- d. Public authorities could award *certificates of excellence* to those platforms and projects with the best results in economic efficiency, social returns and innovative practices. These certificates would provide incentives for participation and a guarantee for safe investments. A committee made up of managers, creators, investors, donors and EU representatives would be responsible for awarding these certificates.

Crowdfunding is attracting the interest of public institutions, but lack of experience and knowledge prevent them from playing a more active role and from taking more direct policy action

- 1- However this potential for novel forms of co-financing and democratic input to funding, is rather limited due to the lack of knowledge on good practice.
- 2- It is still too early to proclaim the technical superiority of one regulatory regime over another as regards crowdfunding.
- 3- Complaints about tax are also affecting the debate on the future of crowdfunding. This is an important debate in all economic sectors, and crowdfunding cannot escape from it.
- 4- Divergence in types of crowdfunding makes it difficult to put forward a common public plan of crowdfunding promotion.

Potential role for policy makers

- a. This report provides good practical examples of how crowdfunding already provides additional inputs and legitimacy for policy action and new innovative funding practices. It is attractive for policy makers as it is a tested experience that promotes growth and employment. The existing experiences of private-public cooperation described in this report could be replicated on a European scale. The idea of setting up strategic relationships with crowdfunding platforms to create fund raising projects is feasible and desirable.
- b. Something similar applies to crowdfunding potential for entrepreneurship and learning as part of an employment strategy. We have little knowledge about how to implement

employment policies in the crowdfunding industry. The literature concurs that there are a growing number of platforms that generate increasing economic activity and employment, but we do not know much on their patterns of success or how to help platforms to implement the most efficient policies to attract investment, and by extension, to promote growth and employment.

- c. Policy action could be taken to prevent problems of *appropriation, clientelism and bureaucratization*. Some of the measures proposed in this report are economically complex and politically problematic, especially those referred to by the definition of public investment, social returns or regulation. Therefore, additional effort should be made to create a cooperative playing field between crowdfunding actors and public institutions where objectives, rules, incentives and practices enjoy a wide consensus.
- d. Crowdfunding is relevant not only for the financing of private businesses, but also as a tool to provide resources to public initiatives where funding tends to be scarce. Public institutions may also act as *receivers of community-based funds* for those projects where resources are very limited. These practices have huge potential and their effect on democratic practices could be very promising.

A European policy option

Some the challenges to crowdfunding described earlier could be addressed by creating a **European Crowdfunding Area (ECA)** with harmonised laws and taxes. The underlying rationale of an ECA would be i) to facilitate the generation of ideas and the transit of these ideas to the market, ii) to encourage entrepreneurial culture, iii) to make it easier to access capital, iv) to reduce the risks of investment and fraud through a flexible, soft and efficient legislative system, v) to encourage citizens' participation through economic incentives for entrepreneurs, investors and donors and vi) to foster transparency in crowdfunding services.

The ECA would also serve as a promoter of bottom-up initiatives and democratic practices by encouraging *the use of crowdfunding to co-fund EU programmes*. European citizens could support those EU programmes that best meet their socio-economic expectations, which would reinforce the legitimacy of EU initiatives. The EU should provide an attractive financial product for citizens that ensures safe investment, fair market interest rate, transparency and a better understanding of EU financing and policy mechanism. This could result in positive inputs for democratisation and accountability.

The ECA could also act as *funder and/or donor of those innovative projects* which have the strongest support on the web. Some of the platforms analysed in this report have good experience in dealing with local administrations. Their experiences can be used to define institutional relationship that best fit into the economic efficiency-democratic practices logic.

9. Identifying Areas of Future Research

Several limitations of the current research evidence have been underlined in this report. Evidence for the real effects of crowdfunding on growth and jobs is scarce, and robust, empirical and differentiated data is needed to establish this is still not available. There is an apparent lack of knowledge on users' socio-economic profiles (age, gender, professional skills, etc.), the causes explaining patterns of success and failure and the empirical connection between users' strategic options and patterns of growth in crowdfunding practices.

We do not know much about the connection between crowdfunding and employment and we lack the empirical data on economic activity and employment that would allow researchers and policy makers to properly evaluate the real economic impact of crowdfunding practices.

Since crowdfunding is used for a variety of different activities, additional knowledge on how different patterns of platform specialisation (equity, lending, rewards and donation) are actually bringing about different modes of crowdfunding practices is needed. We also lack sufficient knowledge of basic crowdfunding elements such as number of platforms actively operating, number of projects, success and failure rates, deal flow, total target budgets submitted, cover rates, etc.

This report suggests that additional studies should be carried out to answer the following sets of issues:

- *Lack of evidence on the impacts and outcomes of crowdfunding for entrepreneurs and creators.* Research needs to address the issues of: how does crowdfunding benefit entrepreneurs and creators? In what circumstances? and what support might they need? This requires studies of how entrepreneurs and creators use different types of crowdfunding, and how they benefit different entrepreneurial activities.
- *Poor understanding of the success factors and conditions.* Studies of success factors in the use of crowdfunding, both exploring from aggregate level across platforms and projects, and the accumulated knowledge of best practice from the platform managers, and from users. This could help to establish what support the different users may need to make the most effective use of crowdfunding platforms.
- *Lack of understanding of the impact and value of different types of platform* Studies are needed that differentiate the activities and markets of different crowdfunding platforms and markets, to establish particular the value and factors shaping success in these different markets and modes of use.
- Issues related to the multiple interplays between crowdfunding and economic outputs are also necessary.
- *Potential impact of regulatory change.* Surveys of regulatory regimes should be conducted in order to improve understanding of the effect of regulatory schemes on the functioning of the crowdfunding industry. These could be complemented by particular cases, and studies of aggregate data in response to change, and monitoring industry and entrepreneur attitudes.
- *Potential and risks for public institutions in the use and support of crowdfunding.* Additional cases of practice involving public institutions would be very useful for policy action and provide examples of good and bad practice. These could be natural cases, or experimental cases (e.g. through the old PROGRESS programme).

- *The rapidly changing nature of crowdfunding, and the lack of general baseline data.* An observatory project could continue to map the changing nature of crowdfunding, and gather unified key data to aid policy making and more specific research.
- *Uncertainty about the risks to investors:* a study of the risks to investors which establishes particular patterns of risk among investors in different markets and under different institutional rules.
- Research to support awareness raising among the non-target population would be of great importance in the promotion of crowdfunding practices. This research would include the following studies which would:
 - identify indicators of crowdfunding's impact within different areas of use (enterprise, social action, creative industry, etc.)
 - estimate crowdfunding's aggregate potential impact if scaled up, based on identified indicators.

10. Conclusions

Crowdfunding is a new financial system with its own particularities. It is a low-cost way of accessing capital, which increases the potential audience for ideas and ventures, reduces the risk of investment, provides tailored financing methods for a wider variety of projects, provides finance in sectors of activity where finance is difficult to obtain and allows entrepreneurs to test the acceptance of their products in a short period of time.

But crowdfunding is also about attracting the emotional interest of users, setting up channels of identification with a platform's core values and purposes and exploiting the capabilities of social networks, community and proximity. This brings about new interactions between economic efficiency and democratic practices which are distinctive of the crowdfunding market.

A particular way of managing these highly idiosyncratic crowdfunding practices seems to have emerged, underlining the advantages of reinforcing the “economic efficiency-democracy practices” mix (Efficiencracy). The interviewed managers reported that transparency, participation, learning communities and open-information benefit economic efficiency, and success reinforces democratic practices.

Managers are committed to reducing investment risk, allowing the best projects, assisting creators and funders, facilitating transactions and verifying customer rights to create a more secure environment for investment and gain in efficiency. They also promote bottom-up initiatives under more transparent rules and practices, allowing new forms of democratic coordination to optimise the relationship between supply and demand forces.

Managers promote democratic practices to encourage trust, involvement and cooperation. They use different strategies to increase the “right participation” by users who identify with platforms' purposes and mission statements (from “ownership for all” to “integrate citizen's credit in the municipal budget”).

So far, public institutions have not been very active in crowdfunding. They are, however, increasingly interested in the possibilities of new sources of revenues, economic growth, employment creation and novel forms of co-financing and democratic input to funding.

Evidence suggests that the development of crowdfunding is likely to be conditioned by increasing specialisation, the emergence of new target areas (science and political activism) and the emergence of a new layer of consultant companies which specialise in crowdfunding services (today in the hands of the manager).

Yet, the expansion of the crowdfunding industry may activate a latent conflict of interests between creators and investors, small and big investors, platforms and public institutions. A series of risks may hinder the consolidation of the crowdfunding market.

Novelty, continual change and lack of research knowledge; accountability and regulatory uncertainty; lack of awareness of good practice; uncertain sustainability of platforms and lack of knowledge and good practice in collaborating with public institutions are serious obstacles for consolidation. The rather limited platform capacity to mediate in conflicts between entrepreneurs and funders, delays in meeting obligation, problems of post-investment communication among stakeholders, the lack of follow-up services to check the sustainability of the launched projects, different tax regimes, two-tier legislation and the preference for the small are also obstacles for the consolidation of the crowdfunding market.

A series of policies recommendation have been suggested in this report, which mainly focus on “awareness raising programmes” in close collaboration with the crowdfunding industry and “learning programmes” for potential users still not familiar with crowdfunding. A “harmonised regulatory

framework” and “reduction of risk programmes” to increase security in transactions, protection of ideas and investment.

The allocation of budget to finance projects which fail to achieve their target budget, reduction of tax burden for crowdfunding services and a certificate of excellence have also been suggested to encourage participation. Similarly crowdfunding opens new spheres of professional activation and labour market inclusion, which require a redefinition of certain patterns of active labour market policies, design, implementation and evaluation.

Some measures have been also suggested to prevent problems of appropriation, clientelism and bureaucratisation when public institutions participate as investors and donors in crowdfunding. Similarly, measures for public institutions to act as receivers of community-based funds have also been suggested. New emphasis on policies promoting international legislation and taxation are recommended under the umbrella of what could be called the European Crowdfunding Area (ECA).

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Abstract

Crowdfunding is an alternative way of finance and exchange where those seeking funding and those looking to invest or donate can be matched. Creators and entrepreneurs can make use of online crowdfunding platforms to expand the pool of potential investors and donors, who contribute via the Internet to the financing their online project. Yet, crowdfunding is not just about raising money, but also about market testing, engaging potential customers and target groups and exploiting the advantages of community and proximity.

Using short cases studies, interviews with platform managers and a review of the literature this report explores the current state of crowdfunding, and makes recommendations for policy and research.

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